

Montgomery County Employee Retirement Plans

Comprehensive Annual Financial Report



Employees' Retirement System Retirement Savings Plan Deferred Compensation Plan *(Trust Funds of Montgomery County, Maryland)*

**Fiscal Year 2005
July 1, 2004 – June 30, 2005**

Prepared by the Board of Investment Trustees
101 Monroe Street, 15th Floor
Rockville, Maryland 20850



Montgomery County, Maryland
EMPLOYEE RETIREMENT PLANS
Fiscal Year Ended June 30, 2005
TABLE OF CONTENTS

Introduction Section	Page
Letter of Transmittal	4
Board of Investment Trustees.....	8
Administrative Organization	9
Organization Chart	10
 Financial Section	
Independent Auditors' Report	12
Management's Discussion and Analysis	15
Financial Statements	
Statements of Plan Net Assets.....	20
Statements of Changes in Plan Net Assets	21
Notes to Financial Statements	22
Required Supplementary Information	
Schedule of Funding Progress.....	32
Schedule of Employer Contributions	32
Notes to Required Supplementary Information.....	33
Schedule of Administrative, Investment and Professional Fees.....	34
Employees' Retirement System	
Statements of Plan Net Assets.....	36
Statements of Changes in Plan Net Assets	37
Retirement Savings Plan	
Statements of Plan Net Assets.....	38
Statements of Changes in Plan Net Assets	39
Deferred Compensation Plan	
Statements of Plan Net Assets.....	40
Statements of Changes in Plan Net Assets	41
 Investment Section - Employees' Retirement System	
Investment Performance, Policy, Statistics and Activity.....	44
Investment Summary - Asset Allocation By Category and Investment Manager	45
Asset Allocation	46
List of Largest Assets Held	47
Schedule of Investment Results.....	48
Compound Annual Return on Investment Portfolio	49
 Actuarial Section - Employees' Retirement System	
Actuary's Certification Letter	52
Summary of Valuation Results.....	57
Summary of Actuarial Assumptions and Methods.....	62
Actuarial Assumptions and Methods.....	63
Analysis of Financial Experience	67
Solvency Test	67
Schedule of Retirees and Survivors.....	68
Schedule of Active Member Valuation Data.....	69
 Statistical Section - Employees' Retirement System	
Schedule of Additions by Source	72
Schedule of Deductions by Type.....	72
Schedule of Benefit Payments by Type.....	73
Schedule of Retired Members by Benefit Type	73
Schedule of Average Benefit Amounts	73
Schedule of Participating Agencies and Political Subdivisions	74





INTRODUCTION SECTION



OFFICES OF THE COUNTY EXECUTIVE

Douglas M. Duncan
County Executive

December 12, 2005

Bruce Romer
Chief Administrative Officer

Honorable County Executive and
Members of the Montgomery County Council

I am pleased to present to you the Comprehensive Annual Financial Report (CAFR) of the Montgomery County, Maryland (County) Employee Retirement Plans (Plans) for the fiscal year ended June 30, 2005. This annual report is designed to assist you in understanding the structure and current status of the Plans.

FORMAL TRANSMITTAL OF THE CAFR

This report was prepared pursuant to the provisions of Section 33-51(b) of the Montgomery County Code, 2001, as amended (Code), and includes the independent auditors' report, issued by the County Council's appointed independent public accounting firm. Responsibility for the accuracy of the presented data and the completeness and fairness of the presentation including all disclosures rests with the County. We believe the data, as presented, is accurate in all material respects; that it is presented in a manner designed to fairly set forth the plan net assets and the changes in plan net assets and financial position of the Plans; and that all disclosures necessary to enable the reader to gain the maximum understanding of the financial affairs of the Plans have been included.

The accompanying report consists of five sections: an **Introduction Section** which contains the Certificate of Achievement, this transmittal letter, and the organization structure; a **Financial Section** which contains the report of the independent auditors, the management's discussion and analysis, the financial statements of the Plans and required supplementary information; an **Investment Section** which contains investment results for the Employees' Retirement System (System) defined benefit pension plan; an **Actuarial Section** which contains the independent actuary's certification letter, a summary of the results of the actuarial valuation, including actuarial procedures and assumptions for the System; and a **Statistical Section** which contains information on the System's membership.

PROFILE OF THE RETIREMENT PLANS

History

The System was established in 1965, as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of the County and other agencies or political subdivisions who elect to participate. Participating agencies and subdivisions include the: Montgomery County Revenue Authority, Housing Opportunities Commission of Montgomery County, independent fire/rescue corporations, Town of Chevy Chase, Strathmore Hall Foundation, Inc., Washington Suburban Transit Commission, and certain employees of the State Department of Assessments and Taxation and the District Court of Maryland. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. There were 5,628 active members and 4,665 retirees participating in the System as of June 30, 2005.



101 Monroe Street • Rockville, Maryland 20850
240/777-2500, TTY 240/777-2544, FAX 240/777-2517
www.co.mo.md.us



The Retirement Savings Plan (RSP) was established in 1994, as a cost-sharing multiple-employer defined contribution plan providing benefits to all non-public safety and certain public safety employees hired on or after October 1, 1994. Employees covered by the System may make an irrevocable decision to transfer to the RSP. At June 30, 2005, there were 3,941 active plan members.

The Deferred Compensation Plan was established pursuant to Section 457 of the Internal Revenue Code, as amended. During Fiscal Year (FY) 1999, in accordance with Federal legislation, the assets of the County Plan were placed in trust for the sole benefit of participants and their beneficiaries. During FY05, the Montgomery County Council passed legislation enabling the County to establish and maintain one or more additional deferred compensation plans for employees covered by a collective bargaining agreement. County non-represented employees, those County represented employees who elected to participate, and employees who were retired at the time of transfer, continue to participate in the Montgomery County Deferred Compensation Plan administered by the County (the County Plan). County represented employees who did not elect to continue to participate in the County Plan may participate in the newly created Montgomery County Union Employees Deferred Compensation Plan (the Union Plan) administered by the bargaining units.

Benefit Provisions

The benefit provisions of the System are established by the Code. The System provides for normal service retirement and early service retirement benefits for members who attain age and service requirements. The System also provides options for disability and death benefits to eligible participants. Members are vested after five years of service.

The RSP provides for immediate vesting of employee contributions and employer contributions are vested after three years of service or upon death, disability or reaching retirement age.

Major Initiatives

During FY 2005, the Board of Investment Trustees (Board) completed an asset/liability study of the plan, which includes an evaluation of the risk/return efficiency of the current asset mix to meet the future projected growth of plan liabilities. As a result of the study, the Board selected a private equity secondary fund-of-funds manager and began reviewing the potential of adding investments within the real estate asset class. Other initiatives during FY 2005 include: establishment of a commission rebate program to lower overall trading expenses and amendment of the risk management program to actively manage the inherent risks associated with the investment process to achieve the highest possible risk adjusted return.

In addition, the Board conducted a structural review of the RSP fund offerings, resulting in the addition of five new funds and the elimination of four funds due to relative performance or duplication of other fund offerings.

INFORMATION USEFUL IN ASSESSING THE RETIREMENT PLANS' ECONOMIC CONDITION

Financial Information

Accounting System and Reports

The Plans' financial statements have been prepared under the accrual basis of accounting. Contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plans.

Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A), which can be found on pages 15 to 19 of this report, provides a brief analysis of the financial performance of the Plans and an introduction to the financial statements of the Plans for the year ended June 30, 2005.

Investments

Montgomery County has established a Board to be responsible for the investment management of the Plans' assets for the exclusive benefit of the members and participants. The Board consists of thirteen members appointed by the County Council.

In overseeing the management of the assets of the Plans, the Board has developed sound and prudent investment policies. The Board believes an appropriate balance must be struck between risks taken and returns sought to ensure the long term health of the defined benefit plan. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets. To achieve this objective, System assets are allocated to a broad array of investment sectors as follows: domestic equities 45 percent, alternative investments 5 percent, international equities 15 percent, domestic fixed income 25 percent, and TIPS 10 percent. For the twelve months ended June 30, 2005, the total return achieved by the System's investments was 10.54 percent, compared to the System's benchmark index return of 9.69 percent and the actuarial assumed rate of return of 8.0 percent.

Section 33-125 of the Montgomery County Code authorizes the Board to establish, for members of the RSP, a diversified slate of mutual and commingled investment funds from which participants may select options. The Board has developed a statement of policies and objectives outlining its oversight of the investment products offered.

The Board has also established a diversified slate of mutual and commingled funds for the County Plan which offers a range of options from which participants may select. The Board has constructed an investment policy stipulating investment objectives and oversight by the Board.

Funding

The System's actuary uses a five-year smoothed market-related value to determine the actuarial value of assets. The smoothing prevents extreme volatility in employer contribution rates due to short-term fluctuations in the investment markets. For the June 30, 2005 valuation, the actuarial value of assets was \$2.1 billion. The aggregate actuarial liability was \$2.8 billion. The Schedule of Funding Progress included as Required Supplementary Information in the Financial Section, expresses the System's actuarial value of assets as a percentage of the actuarial accrued liability, providing one indication of the System's funding status on a going-concern basis. The actuary has determined that the present net asset base, expected future contributions and investment earnings thereon, are sufficient to provide for full payment of future benefits under the projected unit credit actuarial cost method.

Internal Control Structure and Budgetary Controls

The Plans' management is responsible for maintaining internal accounting controls to provide reasonable assurance that transactions are properly authorized and recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. We believe the internal controls in effect during the fiscal year ended June 30, 2005 adequately safeguard the Plans' assets and provide reasonable assurance regarding the proper recording of financial transactions. In addition, the Board, in conjunction with the Chief Administrative Officer, approves and actively monitors the annual budgets for each plan.

Independent Audit and Actuarial Certification

An independent auditors' report and actuarial certification are included in this report.

AWARDS AND ACKNOWLEDGEMENTS

Certificate of Achievement for Excellence in Financial Reporting

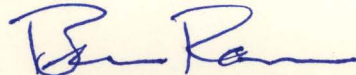
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Montgomery County Employee Retirement Plans for its comprehensive annual financial report for the fiscal year ended June 30, 2004. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such a report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The Montgomery County Employee Retirement Plans have received the Certificate of Achievement for the last five consecutive years. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement program requirements and we are submitting it to the GFOA.

Acknowledgements

The Plans' CAFR was prepared by the Board of Investment Trustees staff in conjunction with staff support from the County's Department of Finance and Office of Human Resources. I would like to express my appreciation to the employees who have worked hard throughout the year to ensure the successful operation of the Plans.

Respectfully submitted,



Bruce Romer
Chief Administrative Officer
Plan Administrator

BOARD OF INVESTMENT TRUSTEES

Stephen B. Farber

Chair

Montgomery County Council Staff Director

Ex-Officio Member

Arthur W. Spengler

Vice Chair

Retired Employees Representative

Term Expires March 2006

Sandra P. Kaiser

Secretary

Montgomery County

Department of Permitting Services

Non-Bargaining Unit Representative

Term Expires March 2008

Mark A. Barnard

Montgomery County Council Representative

Term Expires March 2006

Joseph Adler

Montgomery County Director

Of Human Resources

Ex-Officio Member

Timothy L. Firestine

Montgomery County Director of Finance

Ex-Officio Member

Beverley Swaim-Staley

Montgomery County Director of

Management and Budget

Ex-Officio Member

Cora M. Ingram

Montgomery County Council Representative

Term Expires March 2008

Sharon M. Cayelli

Citizen Representative

Term Expires March 2008

Gino Renne

Employee Organization Representative

Term Expires March 2007

Kelda J.C. Simpson

Citizen Representative

Term Expires March 2008

Jeffrey D. Buddle

Employee Organization Representative

Term Expires March 2008

Walter E. Bader

Employee Organization Representative

Term Expires March 2008

ADMINISTRATIVE ORGANIZATION

Administrative Staff

Joseph Adler
Director – Office of
Human Resources

Timothy L. Firestine
Director of Finance

Linda A. Herman
Executive Director

Professional Services

Actuary

Mercer Human Resource
Consulting
Washington, DC

Investment Consultant

Wilshire Associates
Pittsburgh, PA

Auditor

KPMG LLP
Certified Public Accountants
Washington, DC

Investment Managers-Employees' Retirement System

Capital Guardian Trust Company
Los Angeles, CA

Numeric Investors
Cambridge, MA

Adams Street Partners
Chicago, IL

Marathon London
United Kingdom

Wellington Management
Boston, MA

RhumbLine Advisors
Boston, MA

Mondrian Investment Partners Ltd.
United Kingdom

Goldman Sachs
New York, NY

Systematic Financial Management
Teaneck, NJ

BlackRock Financial Management
New York, NY

Fidelity Investments
Hebron, KY

WR Huff Asset Management Co.
Morristown, NJ

JP Morgan Investment Management
New York, NY

Bridgewater Associates
Westport, CT

Morgan Stanley Asset Management
New York, NY

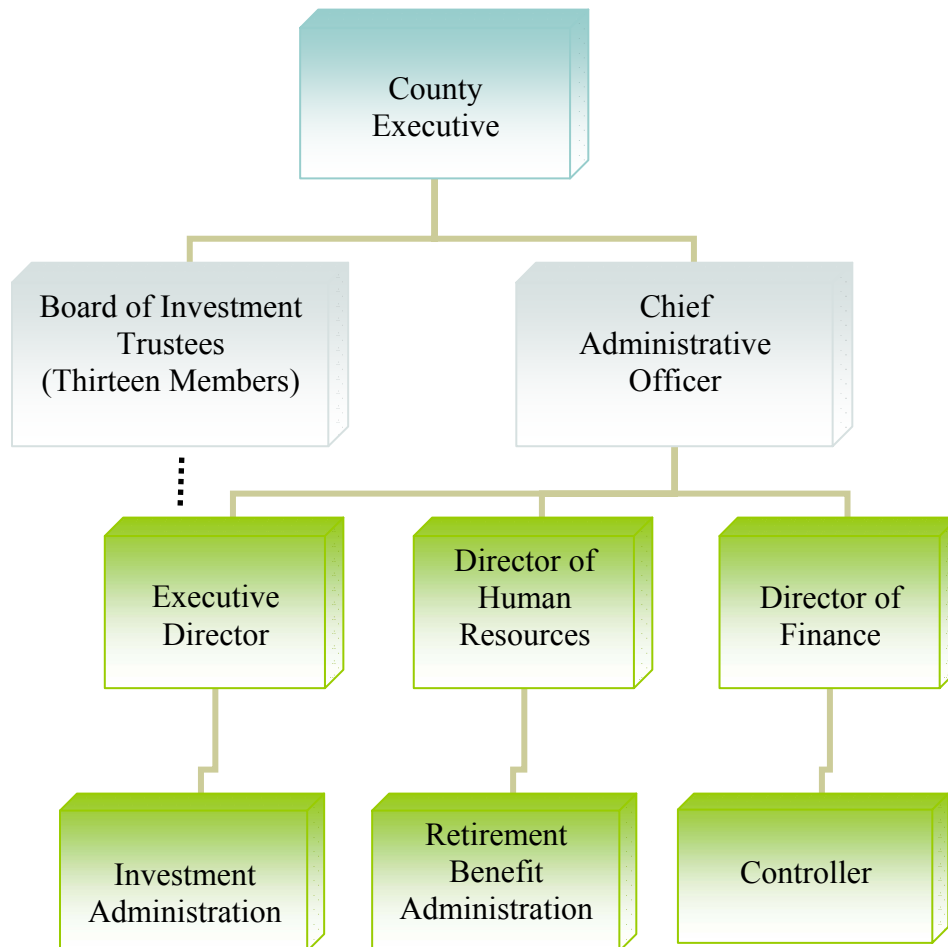
Barclays Global Investors
San Francisco, CA

HarbourVest Partners
Boston, MA

Custodial Bank-Employees' Retirement System

The Northern Trust Company
Chicago, IL

Organization Chart





FINANCIAL SECTION



KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

The County Council of Montgomery County, Maryland

The Board of Trustees
Montgomery County Employees' Retirement Plans:

We have audited the accompanying statements of plan net assets of the Montgomery County Employees' Retirement Plans (the Plans) as of June 30, 2005 and the related statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plans' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plans' internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Plans as of June 30, 2005 and the changes in the plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in the Introduction to the notes to the basic financial statements, the Plans have implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, effective July 2004.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2005 on our consideration of the Plans' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



The Management's Discussion and Analysis on pages 15 through 21 and the schedule of funding progress and notes thereto, on pages 32 and 33, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the 2005 basic financial statements taken as a whole. The 2005 supplementary information on pages 34 through 41 is presented for purposes of additional analysis and is not a required part of the 2005 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2005 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2005 basic financial statements taken as whole. The information included in the introduction, investment, actuarial, and statistical sections has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on such information.

We have also previously audited, in accordance with auditing standards generally accepted in the United States of America, the statements of plan net assets of the Plans as of June 30, 2004, and the related statements of changes in plan net assets for the year then ended (none of which is presented herein), and we expressed an unqualified opinion on those financial statements. The supplementary information included on pages 36 through 41 related to the Plans' 2004 financial statements was subjected to auditing procedures applied in the audit of those basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements from which it has been derived.

KPMG LLP

December 12, 2005



MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The following Management's Discussion and Analysis (MD&A) of the Montgomery County Employee Retirement Plans (Plans) financial performance provides an introduction to the financial statements of the Plans as of and for the year ended June 30, 2005. Since the MD&A is designed to focus on current activities, resulting changes and current known facts, it should be read in conjunction with the transmittal letter in the Introduction Section on page 4, the financial statements, required supplementary information, and other supplementary information which follow this discussion.

Required Financial Statements

The financial statements for the Plans have been prepared under the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, promulgated by the Governmental Accounting Standards Board. The Statements of Plan Net Assets comprise the Plans' assets and liabilities and provide information about the nature and amount of investments, as well as the liabilities distinguished as long-term and other liabilities. The Statements of Changes in Plan Net Assets report the changes of the Plans' net assets, measured by the additions by major sources and deductions by type. Comparative financial statements of the three plans are presented in the latter part of the financial section.

Financial Analysis of the Montgomery County Employee Retirement Plans

Shown below is a condensed presentation of the Net Assets of the Employees' Retirement System (ERS), Retirement Savings Plan (RSP), and Deferred Compensation Plan (DCP) at June 30:

Net Assets (Millions)						
	ERS		RSP		DCP	
	2005	2004	2005	2004	2005	2004
Assets:						
Cash and investments	\$ 2,406.4	\$ 2,268.1	\$ 70.4	\$ 54.9	\$ 186.7	\$ 239.9
Receivables	11.9	10.5	0.8	0.7	0.8	1.1
Total assets	<u>2,418.3</u>	<u>2,278.6</u>	<u>71.2</u>	<u>55.6</u>	<u>187.5</u>	<u>241.0</u>
Liabilities	<u>273.5</u>	<u>303.0</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total net assets	<u>\$ 2,144.8</u>	<u>\$ 1,975.6</u>	<u>\$ 71.2</u>	<u>\$ 55.6</u>	<u>\$ 187.5</u>	<u>\$ 241.0</u>

Shown below is a condensed summary of the Change in Net Assets of the ERS, RSP, and DCP for the years ended June 30:

Change in Net Assets (Millions)						
	ERS		RSP		DCP	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Additions:						
Employer contributions	\$ 74.7	\$ 61.9	\$ 8.7	\$ 6.5	\$ -	\$ -
Member contributions	15.3	14.8	4.8	4.2	19.9	21.6
Net investment income	197.4	286.9	4.7	6.3	14.6	29.4
Total additions	<u>287.4</u>	<u>363.6</u>	<u>18.2</u>	<u>17.0</u>	<u>34.5</u>	<u>51.0</u>
Deductions:						
Benefits	115.6	111.6	-	-	-	-
Refunds	0.8	0.8	2.4	1.4	10.2	9.6
Administrative expenses	1.8	2.1	0.2	0.2	-	-
Movement of member account asset balances	-	-	-	-	77.8	-
Total deductions	<u>118.2</u>	<u>114.5</u>	<u>2.6</u>	<u>1.6</u>	<u>88.0</u>	<u>9.6</u>
Total change in net assets	<u>\$ 169.2</u>	<u>\$ 249.1</u>	<u>\$ 15.6</u>	<u>\$ 15.4</u>	<u>\$ (53.5)</u>	<u>\$ 41.4</u>

The following schedules provide a comparative summary and an analysis of each Plans' assets, liabilities and net assets, at June 30:

Employees' Retirement System			
Net Assets			
(Millions)			
	<u>2005</u>	<u>2004</u>	<u>Percentage Change</u>
Assets:			
Cash and investments	\$ 2,406.4	\$ 2,268.1	6.1 %
Receivables	11.9	10.5	13.3
Total assets	<u>2,418.3</u>	<u>2,278.6</u>	6.1
Liabilities:			
Benefits payable and other liabilities	2.7	2.7	-
Obligations under securities lending agreements	270.8	300.3	(9.8)
Total liabilities	<u>273.5</u>	<u>303.0</u>	(9.7)
Total plan net assets	<u>\$ 2,144.8</u>	<u>\$ 1,975.6</u>	8.6 %

The table shown above reflects an increase in the Employees' Retirement System's net assets of \$169.2 million or 8.6 percent during fiscal year (FY) 2005. The increase reflects improved market conditions over the last twelve months resulting in increased investment earnings. During the previous year net assets increased by \$249.1 million.

Retirement Savings Plan Net Assets (Millions)			
	2005	2004	Percentage Change
Assets:			
Cash and investments	\$ 70.4	\$ 54.9	28.2 %
Receivables	0.8	0.7	14.3
Total assets	<u>71.2</u>	<u>55.6</u>	28.1 -
Liabilities	-	-	-
Total plan net assets	<u>\$ 71.2</u>	<u>\$ 55.6</u>	28.1 %

During FY 2005, net assets increased 28.1 percent to \$71.2 million. The increase is attributable to increased investment earnings. Membership in the Retirement Savings Plan rose from 3,521 at June 30, 2004, to 3,941 at June 30, 2005.

Deferred Compensation Plan Net Assets (Millions)			
	2005	2004	Percentage Change
Assets:			
Investments	\$ 186.7	\$ 239.9	(22.2) %
Receivables	0.8	1.1	(27.3)
Total assets and plan net assets	<u>\$ 187.5</u>	<u>\$ 241.0</u>	(22.2) %

Net assets of the Deferred Compensation Plan decreased 22.2 percent to \$187.5 million during FY 2005. The decrease is due to the transfer of participant balances to the Montgomery County Union Employees Deferred Compensation Plan established by the County during FY05.

Additions

The primary sources of additions for the Plans include member and employer (where applicable) contributions and investment income. The following tables compare the source and amount of additions for each Plan during FY 2005 and FY 2004.

Employees' Retirement System Contributions and Investment Income (Millions)			
	2005	2004	Percentage Change
Employer contributions	\$ 74.7	\$ 61.9	20.7 %
Member contributions	15.3	14.8	3.4
Net investment income	197.4	286.9	(31.2)
	<u>\$ 287.4</u>	<u>\$ 363.6</u>	(21.0) %

During FY 2005, employer contributions to the Employees' Retirement System increased by 20.7 percent due to an increase in the actuarial required contribution based on covered payroll. Member contributions increased by 3.4 percent due to higher pay levels.

The net investment income for the Employees' Retirement System totaled \$197.4 million for FY 2005, comprised of \$156.3 million in net appreciation in fair value of investments, \$47.7 million in dividends and interest, \$6.3 million from securities lending activities, and \$12.9 million related to investment expenses. This is compared to net investment income of \$286.9 million in FY 2004. The decrease in earnings compared to the previous fiscal year is due to market conditions.

Retirement Savings Plan Contributions and Investment Income (Millions)				
	<u>2005</u>	<u>2004</u>	<u>Percentage</u> <u>Change</u>	
Employer contributions	\$ 8.7	\$ 6.5	33.8	%
Member contributions	4.8	4.2	14.3	
Net investment income	<u>4.7</u>	<u>6.3</u>	(25.4)	
	<u>\$ 18.2</u>	<u>\$ 17.0</u>	7.1	%

Employer contributions to the Retirement Savings Plan were \$8.7 million in FY 2005, an increase of 33.8 percent from FY 2004. Member contributions were \$4.8 million in FY 2005, an increase of 14.3 percent from FY 2004. The increase in contributions reflects the increase in the number of participants during FY 2005.

Appreciation in investments reflects the current market conditions.

Deferred Compensation Plan Contributions and Investment Income (Millions)				
	<u>2005</u>	<u>2004</u>	<u>Percentage</u> <u>Change</u>	
Member contributions	\$ 19.9	\$ 21.6	(7.9)	%
Net investment income	<u>14.6</u>	<u>29.4</u>	(50.3)	
	<u>\$ 34.5</u>	<u>\$ 51.0</u>	(32.4)	%

Member contributions to the Deferred Compensation Plan were \$19.9 million for FY 2005, a slight decrease due to the transfer of participants to the Montgomery County Union Employees Plan, compared to \$21.6 million for FY 2004.

Net investment income for the Deferred Compensation Plan was \$14.6 million, compared to the investment income of \$29.4 million in the previous fiscal year, which was primarily due to market conditions.

Deductions

The primary sources of deductions from the Plans include the payment of retiree and survivor benefits, participant refunds, and administrative expenses. The following tables show the use and amount of deductions for each plan during FY 2005 and 2004.

Employees' Retirement System				
Deductions by Type				
(Millions)				
	<u>2005</u>	<u>2004</u>	<u>Percentage Change</u>	
Benefits	\$ 115.6	\$ 111.6	3.6	%
Refunds	0.8	0.8	-	
Administrative expenses	1.8	2.1	(14.3)	
	<u>\$ 118.2</u>	<u>\$ 114.5</u>	3.2	%

During FY 2005, benefit payments increased by 3.6 percent over FY 2004 due primarily to an increase in the number of retirees. Refunds remained at the same level as FY 2004. Administrative expenses decreased slightly in 2005 from \$2.1 million in FY 2004 to \$1.8 million in FY 2005.

Retirement Savings Plan			
Deductions by Type			
(Millions)			
	<u>2005</u>	<u>2004</u>	<u>Percentage Change</u>
Refunds and administrative expenses	<u>\$ 2.6</u>	<u>\$ 1.6</u>	62.5%

The expenses related to the Retirement Savings Plan are comprised of refunds and administrative costs. Expenses for FY 2005 totaled \$2.6 million, an increase of 62.5 percent over FY 2004 levels due primarily to an increase in refunds.

Deferred Compensation Plan			
Deductions by Type			
(Millions)			
	<u>2005</u>	<u>2004</u>	<u>Percentage Change</u>
Refunds and administrative expenses	\$ 10.2	\$ 9.6	6.0 %
Movement of member account asset balances	77.8	-	100.0
	<u>\$ 88.0</u>	<u>\$ 9.6</u>	817.0 %

During FY 2005, refunds distributed from the Deferred Compensation Plan increased by 6 percent over the FY 2004 level. Movement of Member Account Asset Balances represents the transfer of \$77.8 million of participant balances for represented employees who elected to participate in the Union Plan during FY 2005.

MONTGOMERY COUNTY, MARYLAND
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2005

	Employees' Retirement System	Retirement Savings Plan	Deferred Compensation Plan
ASSETS			
Equity in County's pooled cash and investments	\$ 607,687	\$ 439,826	\$ -
Investments:			
U.S. Government and agency obligations	342,255,205	-	-
Asset-backed securities	30,034,502	-	-
Municipal/Provincial bonds	1,143,116	-	-
Corporate bonds	274,681,642	-	-
Collateralized mortgage obligations	9,603,250	-	-
Commercial mortgage-backed securities	13,576,170	-	-
Common and preferred stock	1,387,747,640	-	-
Mutual and commingled funds	697,725	69,986,937	186,691,687
Short-term investments	53,478,063	-	-
Cash collateral received under securities lending agreements	270,825,841	-	-
Real estate holdings	681,790	-	-
Alternative investments	21,090,370	-	-
Total investments	2,405,815,314	69,986,937	186,691,687
Dividends receivable and accrued interest	7,124,154	-	-
Contributions receivable	4,771,937	790,497	770,809
Total assets	2,418,319,092	71,217,260	187,462,496
LIABILITIES			
Payable for collateral received under securities lending agreements	270,825,841	-	-
Benefits payable and other liabilities	2,714,048	27,551	-
Total liabilities	273,539,889	27,551	-
Net assets held in trust for pension benefits	\$ 2,144,779,203	\$ 71,189,709	\$ 187,462,496

(A schedule of funding progress for the Employees' Retirement System is presented on page 32.)

See accompanying notes to financial statements.

MONTGOMERY COUNTY, MARYLAND
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2005

	Employees' Retirement System	Retirement Savings Plan	Deferred Compensation Plan
ADDITIONS			
Contributions:			
Employer	\$ 74,655,371	\$ 8,758,520	\$ -
Members	15,325,785	4,819,587	19,928,984
Total contributions	89,981,156	13,578,107	19,928,984
Investment income	210,337,634	4,692,923	14,587,449
Less investment expenses	12,904,660	24,654	-
Net investment income	197,432,974	4,668,269	14,587,449
Total additions	287,414,130	18,246,376	34,516,433
DEDUCTIONS			
Retiree benefits	102,641,063	-	-
Disability benefits	10,906,765	-	-
Survivor benefits	2,086,755	-	-
Refunds	762,338	2,441,154	10,216,108
Administrative expenses	1,856,977	230,942	16,194
Movement of member account asset balances	-	-	77,837,950
Total deductions	118,253,898	2,672,096	88,070,252
Net increase (decrease)	169,160,232	15,574,280	(53,553,819)
Net assets held in trust for pension benefits:			
Beginning of year	1,975,618,971	55,615,429	241,016,315
End of year	\$ 2,144,779,203	\$ 71,189,709	\$ 187,462,496

See accompanying notes to financial statements.

MONTGOMERY COUNTY EMPLOYEE RETIREMENT PLANS

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

INTRODUCTION

The Montgomery County Employee Retirement Plans (Plans) are offered to Montgomery County (County) employees whose eligibility to participate is based on employment status and other factors. Each of the Plans described below was established under a separate section of the Montgomery County Code (Code). The accompanying notes summarize the significant accounting policies and plan provisions for each of the Plans, including the Employees' Retirement System, a defined benefit pension plan; the Retirement Savings Plan, a defined contribution plan; and the Deferred Compensation Plan, a plan established pursuant to Section 457 of the Internal Revenue Code.

The Plans has adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an Amendment of GASB Statement No. 3*. The primary impact of the Statement to the Plans' financial statements is increased disclosure of the following investment risks and policies related to such risks: interest rate, credit, custodial credit, concentration of credit, and foreign currency.

EMPLOYEES' RETIREMENT SYSTEM - Defined Benefit Pension Plan

The Montgomery County Employees' Retirement System (System or Plan) is considered part of the County's financial reporting entity and is included in the County's basic financial statements as a pension and other employee benefit trust fund. The accompanying financial statements present only the operations of the System in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to public employee retirement systems. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Membership. At June 30, 2005, the date of the latest actuarial valuation, membership in the System consisted of:

Retirees and beneficiaries receiving benefits	4,665
Terminated plan members entitled to but not yet receiving benefits	381
Active plan members	5,628

Plan Description. The System, a cost-sharing multiple-employer defined benefit pension plan, was established in 1965 and is sponsored by the County. Eight other agencies and political subdivisions have elected to participate. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. All covered full-time employees of the County and participating agencies must become members of the System as a condition of employment. All covered career part-time employees of the County and participating agencies may become members on an individual basis.

Funding Policy and Contributions. The System is a contributory plan with employees contributing a percentage of their base annual salary. Contribution rates range from 4 percent to 8.5 percent of regular earnings annually based on group classification and contributions earn interest at the rate of 4 percent per annum as specified under Section 33-39(b) of the Code. The County and each participating agency are required to contribute the remaining amounts necessary to fund the System using the actuarial basis as specified in Section 33-40 of the Code.

Benefit Provisions. Benefit provisions are established under the Code beginning with Section 33-35. All benefits vest at five years of service. There are different retirement groups within the System. Members enrolled before July 1, 1978, belong to either the optional non-integrated group or the optional integrated group. Members enrolled on or after July 1, 1978, belong to the mandatory integrated group. Within the groups are different retirement membership classes. The retirement group assigned depends upon the job classification of the member (i.e., non public safety, police, fire, sheriffs and correctional staff). Normal

and early retirement eligibility, the formula for determining the amount of benefit, and the cost of living adjustment varies depending upon the retirement group and retirement membership class. Normal retirement is a percentage of earnings multiplied by years of credited service. Earnings for optional non-integrated group members and optional integrated group members is defined as the high 12 months and for mandatory integrated plan members, the high 36 months. The percentage of earnings, the maximum years of credited service and the cost of living adjustment varies depending upon the retirement membership class and group. Members who retire early receive normal retirement benefits reduced by a minimum of 2 percent to a maximum of 60 percent depending on the number of years early retirement precedes normal retirement. The System provides options for disability and death benefits to eligible participants. Annual cost-of-living adjustments are provided to retirees and beneficiaries based on the percentage increase in the Consumer Price Index.

Legislation enacted by the Montgomery County Council in November 1999 required the Chief Administrative Officer of the County to establish Deferred Retirement Option Plans, or DROP Plans, allowing any employee who is a member of a specified membership group or bargaining unit, and who meets certain eligibility requirements, to elect to “retire” but continue to work for a specified time period, during which pension payments are deferred. When the member’s participation in the DROP Plan ends, the member must stop working for the County, draw a pension benefit based on the member’s credited service and earnings as of the date that the member began to participate in the DROP Plan, and receive the value of the DROP Plan payoff.

B. Summary of Significant Accounting Policies

Basis of Accounting. The System’s financial statements have been prepared under the accrual basis of accounting. Member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plan. The cost of administering the Plan is paid by the System.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2005. Fair value for real estate investments is determined using unit values supplied by the issuers, which are based upon the issuers’ appraisals of underlying real estate values. Such values involve subjective judgment and may differ from amounts which would be realized if such real estate was actually sold. The fair value for alternative investments is based on information provided by the fund managers. Cash received as collateral on securities lending transactions and investments made with such cash are reported as assets along with a related liability for collateral received.

Equity in County’s Pooled Cash and Investments. The System maintains its cash with the County, which invests cash and allocates interest earned, on a quarterly basis to the System based on the System’s average daily balance of its equity in pooled cash. The County’s policy is to fully collateralize the cash maintained in the pool.

C. Trustees of the Plan

The County established a Board of Investment Trustees (Board) for the System to be responsible for the investment management of the System’s assets for the exclusive benefit of the members. The Board consists of thirteen members appointed by the County Executive and confirmed by the County Council.

D. Investments

Section 33-61 of the Code, authorizes the Board to purchase investments with the care, skill, prudence and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes. The Code also requires that such investments be diversified so as to minimize the risk of large losses unless it is clearly not prudent to diversify under the circumstances. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets. The overall investment policies do not address specific levels of credit risk, interest rate risk or foreign currency risk. The Board believes that risks can be managed, but not eliminated, by establishing constraints on the investment portfolios and by monitoring the financial markets, the System’s asset allocation and the investment managers hired by the System. Each investment manager has

a specific benchmark and investment guidelines appropriate for the type of investments they are managing. Section 33-60 of the Code prohibits the Board from investing in any bonds, notes, or debt instruments issued by Montgomery County, any political subdivision within Montgomery County, any agency supported or financed wholly or partly by taxes levied by the Montgomery County Council, or any agency supported by bond issues underwritten by Montgomery County. Investments in real property are limited to a pooled investment arrangement in which the Board has no power or right to manage the real estate property, provided that the pooled arrangement does not invest more than 10 percent of its assets in real property located in Montgomery County.

Credit Risk/Concentration of Credit Risk. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Board's investment policies and guidelines limit the percentage of the total fund and individual manager's account which can be invested in fixed income securities rated below investment grade. In addition, the Board's investment policies and guidelines limit the percentage of each investment manager's account that may be allocated to any one security, position, issuer or affiliated issuer, to less than 5 percent of the fair value of the investment manager's account. The System does not have investments (other than those issued or explicitly guaranteed by the U.S. Government or pooled investments) in any one organization that represent 5 percent or more of net assets held in trust for pension benefits.

The quality ratings of investments in fixed income securities as described by nationally recognized rating organizations as of June 30, 2005 are as follows:

Type of Investment	Quality Rating	Fair Value	Percentage of Portfolio
U.S. Government Obligations*	AAA	\$ 165,585,072	22.83%
	Unrated	26,892,496	3.71%
Foreign Government Obligations	AAA	89,503,655	12.34%
	AA	16,383,306	2.26%
	A	1,477,406	0.20%
	BBB	7,041,913	0.97%
	BB	4,015,682	0.55%
	B	420,920	0.06%
	Unrated	30,934,755	4.26%
Asset-Backed Securities	AAA	28,996,110	4.00%
	AA	363,634	0.05%
	A	674,758	0.09%
Commercial Mortgage-Backed Securities	AAA	13,173,740	1.82%
	AA	402,430	0.06%
Collateralized Mortgage Obligations	AAA	7,016,865	0.97%
	Unrated	2,586,385	0.36%
Municipal /Provincial Bonds	Unrated	1,143,116	0.16%
Corporate Bonds	AAA	9,099,732	1.25%
	AA	13,383,469	1.85%
	A	29,184,742	4.02%
	BBB	32,293,552	4.45%
	BB	41,178,112	5.68%
	B	37,228,186	5.13%
	CCC	467,500	0.06%
	Unrated	9,114,964	1.26%
Fixed Income Pooled Funds	AA	102,731,385	14.16%
Short-term Investments and Other	AA	465,000	0.06%
	NA	53,620,750	7.39%
Total Fixed Income Securities		<u>\$ 725,379,635</u>	<u>100.00%</u>

*Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not have purchase limitations.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investment. The Board's investment policies and guidelines manage interest rate risk by establishing duration constraints on each fixed income manager's portfolio based on the duration of each manager's respective benchmark. Duration is a measure of interest rate risk based on a bond price's sensitivity to a 100-basis point change in interest rates. The greater the duration of a bond, or a portfolio of bonds, the greater its price volatility will be in response to a change in interest rates and vice-versa. Duration of eight would mean that, given a 100-basis point change up/down in rates, a bond's price would move up/down by 8 percent. As of June 30, 2005, the System's fixed income portfolio had the following sensitivity to changes in interest rates:

Type of Investment	Effective Duration in Years	Fair Value	Percentage of Portfolio
U.S. Government Obligations	4.54	\$ 192,477,568	26.53%
Foreign Government Obligations	9.74	149,777,637	20.65%
Asset-Backed Securities	1.19	30,034,502	4.14%
Commercial Mortgage-Backed Securities	3.19	13,576,170	1.87%
Collateralized Mortgage Obligations	1.38	9,603,250	1.32%
Municipal /Provincial Bonds	N/A	1,143,116	0.16%
Corporate Bonds	5.03	171,950,257	23.71%
Fixed Income Pooled Funds	1.18	102,731,385	14.16%
Short-term Investments and Other	N/A	54,085,750	7.46%
Total Fixed Income Securities		<u>\$ 725,379,635</u>	<u>100.00%</u>

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The Board's International Investing Policy's objective is to achieve long-term capital appreciation and current income by investing in diversified portfolios of non-U.S. equities and bonds. The System has indirect exposure to foreign currency risk as follows:

International Securities	Equity	Fixed Income	Short-term and Other	Total Non-U.S. Dollar
Japanese Yen	\$ 70,719,983	\$ -	\$ 12,433,716	\$ 83,153,699
British Pound Sterling	48,623,164	23,566,631	(14,380,620)	57,809,175
European Currency Unit	71,355,117	43,943,211	(64,101,543)	51,196,785
Swiss Franc	14,014,394	139,376	1,432,306	15,586,076
Australian Dollar	5,545,464	-	8,015,308	13,560,772
Hong Kong Dollar	10,439,142	-	-	10,439,142
Swedish Krona	7,629,866	19,090,677	(18,488,880)	8,231,663
Canadian Dollar	6,411,014	17,800,624	(19,696,645)	4,514,993
South African Rand	3,934,220	-	-	3,934,220
Thai Baht	3,372,338	-	4	3,372,342
Other Currencies	15,118,491	2,329,169	(2,139,162)	15,308,498
Total International Securities	<u>\$ 257,163,193</u>	<u>\$ 106,869,688</u>	<u>\$ (96,925,516)</u>	<u>\$ 267,107,365</u>

Derivatives. The System invests in derivative instruments on a limited basis in accordance with the Board's policy. During FY 2005, the System invested directly in various derivatives including asset-backed securities, collateralized mortgage obligations, exchanged-traded future contracts, forward currency contracts, and floating rate securities. Investment managers are specifically prohibited from purchasing securities on margin or leverage. The System entered into these investments either to increase earnings or to hedge against potential losses. These investments generally contain market risk resulting from fluctuations in interest and currency rates. The credit risk of these investments is associated with the creditworthiness of the related parties to the contracts. At June 30, 2005, direct investments in derivatives represented 13.8 percent of the total fair value of the System's portfolio. In addition, the System has

indirect exposure to market and credit risk through its ownership interests in certain mutual and commingled funds which may hold derivative financial instruments.

As permitted by the Board's policies, the System holds off-financial statement derivatives in the form of exchange-traded financial futures and interest rate swaps. An exchange-traded financial futures contract is a legally-binding agreement to buy or sell a financial instrument in a designated future month at a price agreed upon by the buyer and seller at initiation of the contract. Futures contracts are standardized according to quality, quantity and delivery time. Exchange-traded financial futures are used to adjust asset class exposures to achieve target allocations to U.S. fixed income in the form of U.S. Treasury securities. Futures provide a means to achieve these exposures in a more efficient way and at lower transaction costs. To maintain the target level of exposure to fixed income, U.S. Treasury futures contracts are purchased and sold. As of June 30, 2005 the System held the following futures contracts:

<u>Type</u>	<u>Notional Value</u>	<u>Maturity</u>
Foreign Currency	\$ 35,190,535	September 2005
	66,762,107	December 2005
	47,890,659	March 2006
	3,599,813	June 2006
Interest Rate	51,925,323	August 2005
	(19,698,733)	September 2005
	(13,540,671)	December 2005
	13,244,696	March 2006
	1,189,122	June 2006
	(21,835,450)	September 2006
U.S. Government Bond	(34,720,537)	September 2005
	5,630,469	December 2005
Foreign Government Bond	45,183,627	September 2005

Securities Lending. Board policy permits the System to lend its securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The System's custodian is the agent in lending the System's securities for collateral of 102 percent for domestic and 105 percent for international securities. The custodian receives cash, securities or irrevocable bank letters of credit as collateral. All securities loans can be terminated on demand by either the System or the borrower. Cash collateral received from the borrower is invested by the lending agent, as an agent for the System, in a short-term investment pool in the name of the System, with guidelines approved by the Board. Such investments are considered a collateralized investment pool. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of securities loans made by other plan entities that invest cash collateral in the investment pool, which the System cannot determine. The System records a liability for the return of the cash collateral shown as collateral held for securities lending in the statement of net assets. The Board does not restrict the amount of loans the lending agent may make on its behalf. The agent indemnifies the System by agreeing to purchase replacement securities, or return the cash collateral thereof, in the event a borrower fails to return loaned securities or pay distributions thereon. There were no such failures by any borrower during the fiscal year, nor were there any losses during the period resulting from a default of the borrower or lending agent.

As of June 30, 2005, the fair value of securities on loan was \$300,036,600. Cash received as collateral and the related liability of \$270,825,841 as of June 30, 2005, is shown on the Statement of Plan Net Assets. Securities received as collateral are not reported as assets since the System does not have the ability to pledge or sell the collateral securities absent borrower default. Securities lending revenues and expenses amounting to \$6,289,677 and \$5,695,038, respectively, have been classified with investment income and investment expenses, respectively, in the accompanying financial statements.

The following represents the balances relating to the securities lending transactions at June 30, 2005:

Securities Lent	Underlying Securities	Non-Cash Collateral Value	Cash Collateral Investment Value
Lent for Cash Collateral:			
U.S. Government Obligations	\$ 85,420,501	\$ -	\$ 87,193,042
Foreign Government Obligations	3,767,570	-	3,935,356
Corporate Bonds	29,065,015	-	29,785,063
Equities	145,250,343	-	149,912,380
Lent for Non-Cash Collateral:			
U.S. Government Obligations	31,527,130	32,311,419	-
Corporate Bonds	2,433,840	2,486,781	-
Equities	2,572,201	2,637,005	-
Total	<u>\$ 300,036,600</u>	<u>\$ 37,435,205</u>	<u>\$ 270,825,841</u>

At year-end, the System has no credit risk exposure to borrowers because the amounts the System owes the borrowers exceeded the amounts the borrowers owe the System. The System is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. At June 30, 2005, there were no funds held by a counterparty that was acting as the System's agent in securities lending transactions.

E. Allocated Insurance Contract

On August 1, 1986, the County entered into an agreement with Aetna Life Insurance Company (Aetna) wherein Aetna accepted future responsibility for monthly payments to all members retired prior to January 1, 1986, in exchange for a lump sum payment. The County is liable for cost of living increases effective January 1, 1986, and later. Monthly payments made under this agreement have not been recognized in the System's financial statements.

F. Income Taxes

The Internal Revenue Service issued a determination letter in January 2003, which stated that the System and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes. In the opinion of the plan administrator, the System and its underlying trust have operated within the terms of the System and are qualified under the applicable provisions of the Internal Revenue Code.

RETIREMENT SAVINGS PLAN - Defined Contribution Pension Plan

The Montgomery County Retirement Savings Plan (Plan) is considered part of the County's financial reporting entity and is included in the County's basic financial statements as a pension and other employee benefit trust fund. The accompanying financial statements present only the operations of the Plan in conformity with GAAP. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Membership. At June 30, 2005 membership in the Plan consisted of:

Active plan members	3,520
Inactive plan members	421

Plan Description. The Plan, a cost-sharing multiple-employer defined contribution plan, was established in 1994 and is sponsored by the County. Eight other agencies or political subdivisions have elected to participate. All non-public safety and certain public safety employees not represented by a collective bargaining agreement and hired on or after October 1, 1994 are covered by the Plan. Eligible employees covered by the Montgomery County Employees' Retirement System may make an irrevocable decision to transfer to this Plan.

Contributions. Under Section 33-116 of the Code, the Plan requires employees to contribute 3 percent of regular earnings up to the Social Security wage base and 6 percent above the Social Security wage rate. Section 33-117 of the Code requires the County to contribute 6 percent and 10 percent of regular earnings for non-public safety and public safety employees, respectively.

Benefit Provisions. Employee contributions vest immediately and employer contributions are vested after three years of service or upon death, disability, or reaching retirement age. Members are fully vested upon reaching normal retirement (age 62) regardless of years of service. At separation, a participant's benefit is determined based upon the account balance which includes contributions and investment earnings.

B. Summary of Significant Accounting Policies

Basis of Accounting. The Plan's financial statements have been prepared under the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plan. The cost of administering the Plan is paid by the County and participating agencies.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2005.

Equity in County's Pooled Cash and Investments. The Plan maintains its cash with the County, which invests cash and allocates interest earned, on a quarterly basis to the Plan based on the Plan's average daily balance of its equity in pooled cash. The County's policy is to fully collateralize the cash maintained in the pool.

C. Trustees of the Plan

The County established a Board of Investment Trustees (Board) for the Trust to oversee the investment program. The Board consists of thirteen members appointed by the County Executive and confirmed by the County Council.

D. Investments

Section 33-125 of the Code authorizes the Board to establish a diversified slate of mutual and commingled investment funds from which participants may select an option. The Board exercises the Standard of Care as delineated in Section 33-61 of the Code. As of June 30, 2005, the fair value of the mutual and commingled investment funds was \$69,986,937. The fair value of the investments in international mutual funds was \$1,720,879.

E. Income Taxes

The Internal Revenue Service issued a determination letter in December 2002, which stated that the Plan and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes. In the opinion of the plan administrator, the Plan and its underlying trust have operated within the terms of the Plan and are qualified under the applicable provisions of the Internal Revenue Code.

DEFERRED COMPENSATION PLAN

During FY 2005, the Montgomery County Council passed legislation enabling the County to establish and maintain one or more additional deferred compensation plans for employees covered by a collective bargaining agreement. County non-represented employees, those County represented employees who elected to participate, and employees who were retired at the time of transfer, continue to participate in the Montgomery County Deferred Compensation Plan administered by the County (the County Plan). County represented employees who did not elect to continue to participate in the County Plan may participate in the newly created Montgomery County Union Employees Deferred Compensation Plan (the Union Plan) administered by the bargaining units. The purpose of these Plans is to extend to employees deferred compensation plans pursuant to Section 457 of the Internal Revenue Code of 1986, as amended.

The accompanying financial statements present only the operations of the County Plan in conformity with GAAP. They are not intended to present fairly the financial position and results of operations of the entire County. The assets of the Union Plan are not included in the accompanying financial statements since neither the County nor the Board of Investment Trustees (Board) have fiduciary or other responsibility for the Union Plan except as required by federal law, including any regulation, ruling, or other guidance issued under law. For represented employees who elected to participate in the Union Plan, the \$77.8 million transfer of their account balances from the County Plan to the Union Plan has been reported as Movement of Member Account Asset Balances in the accompanying Statement of Changes in Plan Net Assets.

A. Plan Description and Contribution Information

Plan Description and Contributions. During 1999, in accordance with Federal legislation, the assets were placed in Trust for the sole benefit of participants and their beneficiaries. Trust responsibilities for the County Plan are assigned to the Board. The Board has a third-party administrator contract to provide investment vehicles and administrative services to plan participants. Under the County Plan, contributions are sent to the providers for different types of investments as selected by the participants. A separate account, which reflects the monies deferred, investment of the monies, and related investment earnings is maintained for each participant by the third-party administrator. Withdrawals are made upon retirement, termination of employment, death, and/or in unforeseeable emergencies.

B. Summary of Significant Accounting Policies

Basis of Accounting. The County Plan's financial statements have been prepared under the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Distributions are recognized when paid in accordance with the terms of the County Plan, and administrative costs are recognized as incurred.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2005.

C. Trustees of the Plan

The County established a Board to oversee the investment program of the County Plan. The Board consists of thirteen members appointed by the County Executive and confirmed by the County Council.

D. Investments

The Board is required to establish a diversified slate of mutual and commingled funds from which participants may select investment options. The Board exercises the Standard of Care as delineated in Section 33-61 of the Code. As of June 30, 2005, the fair value of the mutual and commingled investment funds was \$186,691,687. The fair value of the investments in international mutual funds included in the County Plan was \$8,849,337.

REQUIRED SUPPLEMENTARY INFORMATION

Historical trend information about the Employees' Retirement System (System) defined benefit pension plan is presented below as required supplementary information. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/00	\$1,911,114,401	\$1,931,914,313	\$ 20,799,912	98.9 %	\$299,649,316	6.9 %
6/30/01	1,990,882,017	2,111,946,453	121,064,436	94.3	290,751,709	41.6
6/30/02	2,036,100,709	2,273,179,216	237,078,507	89.6	298,456,852	79.4
6/30/03	2,029,314,438	2,411,492,724	382,178,286	84.2	312,057,363	122.5
6/30/04	2,045,098,796	2,561,328,232	516,229,436	79.8	318,815,374	161.9
6/30/05	2,100,532,623	2,775,047,412	674,514,789	75.7	328,459,150	205.4

Analysis of the dollar amounts of plan net assets, actuarial accrued liability, and unfunded actuarial accrued liability in isolation can be misleading. Expressing the assets as a percentage of the actuarial accrued liability provides one indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the system. Trends in the unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the system's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
2000	\$ 44,347,078	100 %
2001	43,345,296	100
2002	39,168,622	100
2003	55,205,855	100
2004	61,927,029	100
2005	74,655,371	100

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows.

Valuation date	June 30, 2005
Actuarial cost method	Projected unit credit
Amortization method	Level dollar amount
Remaining amortization period	40 year period based on closed periods
Asset valuation method	5-Year phase-in of market gains/losses
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases depending on age	4.75% - 7.50%
Cost-of-living adjustments	3.5%
Post-Retirement Increases	Consumer Price Index - by Group
Mortality rates after retirement	RP 2000 projected 10 years, separate tables for males and females

The actuarial assumptions used have been recommended by the actuary and adopted by the County's Chief Administrative Officer based on the most recent review of the System's experience, completed as of June 30, 2005.

The rate of employer contributions to the plan is composed of the normal cost, amortization of the unfunded actuarial liability and an allowance for administrative expenses. The normal cost is a level percent of pay cost which, along with the member contributions, will pay for projected benefits at retirement for the average plan participant. The actuarial liability is that portion of the present value of projected benefits that will not be paid by future employer normal costs or member contributions. The difference between this liability and the funds accumulated as of the same date is the unfunded actuarial liability.

SCHEDULE OF ADMINISTRATIVE, INVESTMENT AND PROFESSIONAL FEES
EMPLOYEES' RETIREMENT SYSTEM
FOR THE YEAR ENDED JUNE 30, 2005

SCHEDULE OF ADMINISTRATIVE EXPENSES

Personnel Services:	
Salaries and wages	\$ 698,171
Retirement contributions	85,719
Insurance	79,279
Social security	60,943
Total personnel services	<u>924,112</u>
Professional Services:	
Actuarial	211,025
Independent public accountants	30,320
Outside legal	24,090
Intern	1,601
Total professional services	<u>267,036</u>
Benefit Processing:	
Disbursement services	252,844
Disability management	226,426
Total benefit processing	<u>479,270</u>
Due diligence and continuing education	<u>8,879</u>
Office Management:	
Rent and related charges	90,552
Communications	25,502
Office equipment and supplies	61,502
Miscellaneous	124
Total office management	<u>177,680</u>
Total administrative expenses	<u>\$ 1,856,977</u>

SCHEDULE OF PROFESSIONAL SERVICES FEES

Professional Services Fees:	
Mercer Human Resource Consulting	\$ 211,025
KPMG LLP	30,320
Total professional services fees	<u>\$ 241,345</u>

(Continued)

SCHEDULE OF ADMINISTRATIVE, INVESTMENT AND PROFESSIONAL FEES, CONCLUDED
EMPLOYEES' RETIREMENT SYSTEM
FOR THE YEAR ENDED JUNE 30, 2005

SCHEDULE OF INVESTMENT EXPENSES

Investment Management Fees:	
Aetna Life Insurance Company	\$ 3,563
The Northern Trust Company	266,750
Marathon	996,761
BlackRock Financial Management	451,545
Wellington Management	561,483
Bridgewater Associates	388,483
RhumbLine Advisors	76,444
Systematic Financial Management	582,015
Mondrian Investment Partners Ltd.	65,500
Barclays Global Investments	67,292
Numeric Investors	1,247,343
WR Huff Asset Management Co.	507,244
JP Morgan Investment Management	473,868
Capital Guardian Trust Company	716,449
Goldman Sachs	568,802
Fidelity Investments	<u>30</u>
Total investment management fees	<u>6,973,572</u>
Other Investment Related Expenses:	
Bloomberg Financial Systems	17,940
Wilshire Associates	218,111
Securities lending borrower rebates	5,440,478
Securities lending agent fees	<u>254,559</u>
Total other investment related expenses	<u>5,931,088</u>
Total investment expenses	<u><u>\$ 12,904,660</u></u>

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2005 AND 2004

	2005	2004
ASSETS		
Equity in County's pooled cash and investments	\$ 607,687	\$ 533,502
Investments:		
U.S. Government and agency obligations	342,255,205	224,583,856
Asset-backed securities	30,034,502	25,130,943
Municipal/Provincial bonds	1,143,116	745,819
Corporate bonds	274,681,642	283,610,976
Collateralized mortgage obligations	9,603,250	3,308,835
Commercial mortgage-backed securities	13,576,170	3,214,617
Common and preferred stock	1,387,747,640	1,319,682,926
Mutual and commingled funds	697,725	580,139
Short-term investments	53,478,063	96,168,794
Cash collateral received under securities lending agreements	270,825,841	300,257,113
Real estate holdings	681,790	3,697,613
Alternative investment	21,090,370	6,563,331
Total investments	2,405,815,314	2,267,544,962
Dividends receivable and accrued interest	7,124,154	6,630,325
Contributions receivable	4,771,937	3,893,796
Total assets	2,418,319,092	2,278,602,585
LIABILITIES		
Payable for collateral received under securities lending agreements	270,825,841	300,257,113
Benefits payable and other liabilities	2,714,048	2,726,501
Total liabilities	273,539,889	302,983,614
Net assets held in trust for pension benefits	\$ 2,144,779,203	\$ 1,975,618,971

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
ADDITIONS		
Contributions:		
Employer	\$ 74,655,371	\$ 61,927,029
Members	15,325,785	14,761,912
Total contributions	89,981,156	76,688,941
Investment Income:		
Net appreciation in fair value of investments	156,359,022	249,149,635
Dividends and interest	47,688,935	43,738,500
Income from securities lending activities	6,289,677	2,834,615
Total investment income	210,337,634	295,722,750
Less investment expenses	12,904,660	8,827,650
Net investment income	197,432,974	286,895,100
Total additions	287,414,130	363,584,041
DEDUCTIONS		
Retiree benefits	102,641,063	87,122,662
Disability benefits	10,906,765	19,491,388
Survivor benefits	2,086,755	5,031,935
Refunds	762,338	796,099
Administrative expenses	1,856,977	2,066,265
Total deductions	118,253,898	114,508,349
Net increase	169,160,232	249,075,692
Net assets - beginning of year	1,975,618,971	1,726,543,279
Net assets - end of year	\$ 2,144,779,203	\$ 1,975,618,971

RETIREMENT SAVINGS PLAN
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2005 AND 2004

	2005	2004
ASSETS		
Equity in County's pooled cash and investments	\$ 439,826	\$ 524,214
Investments	69,986,937	54,446,315
Contributions receivable	<u>790,497</u>	<u>684,896</u>
Total assets	71,217,260	55,655,425
LIABILITIES		
Accrued expenses	<u>27,551</u>	<u>39,996</u>
Net assets held in trust for pension benefits	<u>\$ 71,189,709</u>	<u>\$ 55,615,429</u>

RETIREMENT SAVINGS PLAN
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
ADDITIONS		
Contributions:		
Employers	\$ 8,758,520	\$ 6,468,353
Members	<u>4,819,587</u>	<u>4,208,196</u>
Total contributions	<u>13,578,107</u>	<u>10,676,549</u>
Investment income	4,517,843	6,222,567
Less investment expenses	<u>24,654</u>	<u>79,070</u>
Net investment income	<u>4,493,189</u>	<u>6,143,497</u>
Other income	<u>175,080</u>	<u>210,392</u>
Total additions	<u>18,246,376</u>	<u>17,030,438</u>
DEDUCTIONS		
Refunds	2,441,154	1,382,451
Administrative expenses	<u>230,942</u>	<u>247,277</u>
Total deductions	<u>2,672,096</u>	<u>1,629,728</u>
Net increase	15,574,280	15,400,710
Net assets - beginning of year	<u>55,615,429</u>	<u>40,214,719</u>
Net assets - end of year	<u>\$ 71,189,709</u>	<u>\$ 55,615,429</u>

DEFERRED COMPENSATION PLAN
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2005 AND 2004

	2005	2004
ASSETS		
Investments	\$ 186,691,687	\$ 239,923,463
Contributions receivable	<u>770,809</u>	<u>1,092,852</u>
Total assets and net assets held in trust for pension benefits	<u><u>\$ 187,462,496</u></u>	<u><u>\$ 241,016,315</u></u>

DEFERRED COMPENSATION PLAN
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
ADDITIONS		
Contributions - members	\$ 19,928,984	\$ 21,610,024
Investment income	<u>14,587,449</u>	<u>29,455,876</u>
Total additions	<u>34,516,433</u>	<u>51,065,900</u>
DEDUCTIONS		
Member refunds	10,216,108	9,634,643
Administrative expenses	16,194	5,564
Movement of member account asset balances	<u>77,837,950</u>	<u>-</u>
Total deductions	<u>88,070,252</u>	<u>9,640,207</u>
Net (decrease) increase	(53,553,819)	41,425,693
Net assets - beginning of year	<u>241,016,315</u>	<u>199,590,622</u>
Net assets - end of year	<u>\$ 187,462,496</u>	<u>\$ 241,016,315</u>





INVESTMENT SECTION

Employees' Retirement System

EMPLOYEES' RETIREMENT SYSTEM

INVESTMENT PERFORMANCE, POLICY, STATISTICS AND ACTIVITY

For the fiscal year, the System's investment return was 10.54 percent. Return data for the System was calculated on a time weighted basis in accordance with the standards of the Association of Investment Management & Research (AIMR) by the System's custodian bank, The Northern Trust Company. Valuations are based on published national securities exchange prices, where available, and all valuations are reconciled between the various investment managers and the custodian bank. The following pages were prepared by the Board of Investment Trustees (Board) staff.

In the investment of public funds, adequate funding of employee retirement benefits at a reasonable and affordable cost is a paramount concern. An appropriate balance must be struck between risks taken and returns sought to ensure the long term health of the System. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets.

Specific investment objectives include:

- To realize the actuarial assumed rate of return of 8 percent, annually.
- To manage portfolio risk so as to limit potential downside fluctuations in the value of the total System assets.
- To realize as high a rate of total return as possible consistent with the above.

To achieve these objectives, the following investment policies are employed:

- Allocate System assets to a broad array of investment sectors as follows: Domestic equities 45%, alternative investments 5%, international equities 15%, domestic fixed income 25% and TIPS 10%.
- Maintain the asset allocation stated above, within a +/-3% range.
- Monitor the individual investment manager's market value to ensure compliance with the Board's Manager Funding Policy.
- Evaluate the performance of all investment managers against their specific performance and style objectives and against the returns achieved by other similar managers.
- Evaluate the System's overall risk exposure and modify investments through rebalancing when necessary.

Charts and tables are enclosed indicating the System's:

- Asset allocation
- Investment managers with assignments
- List of largest assets held
- Investment performance for various periods

EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT SUMMARY
ASSET ALLOCATION BY ASSET CLASS AND INVESTMENT MANAGER
AS OF JUNE 30, 2005

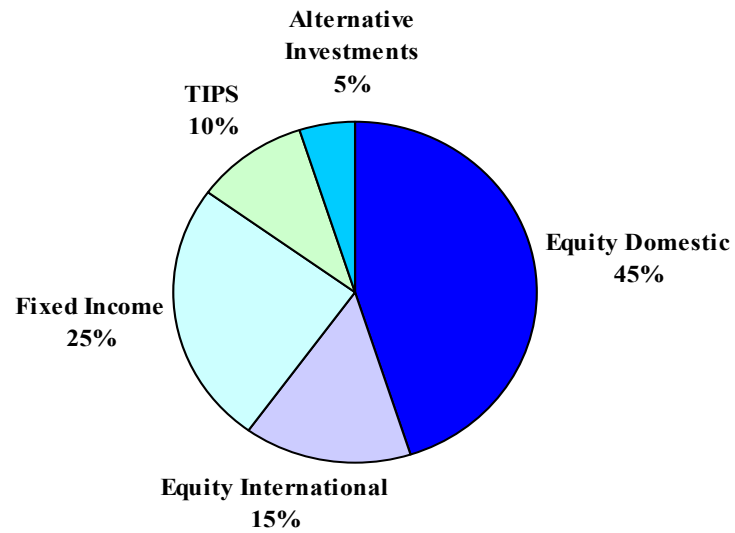
Asset Class		Fair Value	% of Total
Manager	Investment Style	\$000	Fair Value
Domestic Equities			
BGI Russell 3000 Fund*	Passive Russell 3000 Index	\$ 238,370	11.1%
RhumbLine Advisors	Passive Russell 1000 Index	225,320	10.5%
Systematic Financial Mgt.	Active Large Cap Value	158,757	7.4%
Numeric Investors	Active Large Cap Core	151,223	7.1%
Goldman Sachs	Active Large Cap Growth	145,874	6.8%
Wellington	Active Small Cap Value	70,799	3.3%
Numeric Investors	Active Small Cap Growth	69,022	3.2%
Fidelity Investments*	Commingled Funds	698	0.0%
Alternative Investments			
Adams Street *	Private Equity Fund-of-Funds	11,368	0.5%
HarbourVest *	Private Equity Fund-of-Funds	9,722	0.5%
International Equities			
Marathon	Active EAFE	165,467	7.7%
Capital Guardian	Active EAFE	106,001	4.9%
Mondrian*	Active Emerging Markets Fund	45,894	2.1%
BGI EAFE Fund*	Passive EAFE Index	7,703	0.4%
Real Estate			
Total Real Estate Funds*	Active Equity	682	0.0%
Fixed Income			
JP Morgan	Active Core Plus	184,761	8.6%
BlackRock	Active Core Plus	212,669	10.0%
WR Huff	High Yield	105,145	5.0%
BGI US Debt Fund*	Passive Lehman Aggregate Index	23,583	1.1%
TIPS			
Bridgewater	TIPS	194,589	9.1%
Cash*			
	Active Short Term	15,074	0.7%
Total Assets**		<u>\$ 2,142,721</u>	<u>100.0%</u>

* Pooled Funds

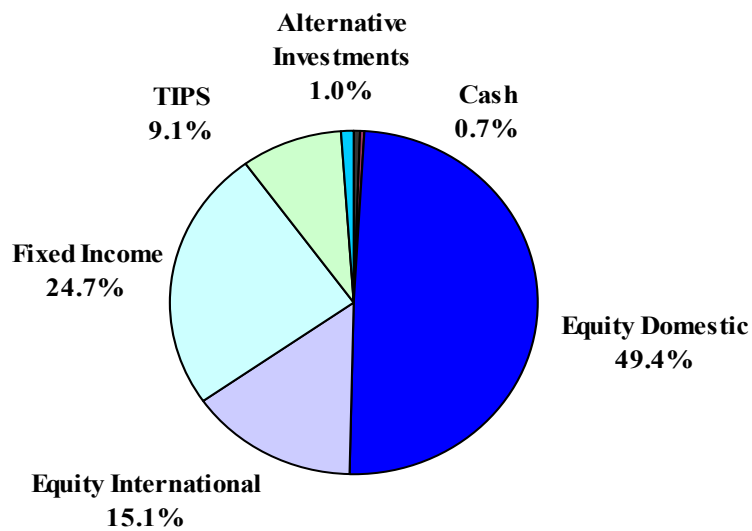
**Without Cash Collateral and Contributions Receivable.

EMPLOYEES' RETIREMENT SYSTEM

Target Asset Allocation



Asset Allocation June 30, 2005



EMPLOYEES' RETIREMENT SYSTEM
LIST OF LARGEST ASSETS HELD
JUNE 30, 2005

Fifteen Largest Equity Holdings	Shares	Value
Exxon Mobil	332,500	\$ 19,108,775
General Electric	517,400	17,927,910
Microsoft	596,880	14,826,499
Bank of America	319,388	14,567,287
Citigroup	278,902	12,893,639
Intel	420,200	10,950,412
Pfizer	394,050	10,867,899
Telewest Global	447,656	10,197,604
Wal-Mart Stores	186,800	9,003,760
Verizon Communication	254,200	8,782,610
Pepsico	150,462	8,114,416
NTL	112,914	7,725,576
Altria Group	112,700	7,287,182
Procter & Gamble	138,100	7,284,775
FHLMC	111,150	7,250,315

Fifteen Largest Fixed Income Holdings	Interest Rate	Maturity Date	Market Value
Federal National Mortgage Assn. 30-year Pass-Throughs	5.500 %	July 15, 2034	\$ 25,842,669
United States Treasury Inflation-Linked Bonds	3.875	April 15, 2029	21,290,809
United States Treasury Notes	3.750	March 31, 2007	16,625,282
Federal National Mortgage Assn. TBA Pool 30-year	6.000	August 11, 2005	11,059,870
Federal National Mortgage Assn. Single Family Mortgage 15-year	5.000	July 19, 2005	10,412,661
United States Treasury Notes	3.375	February 28, 2007	9,363,853
France Government OATEI	3.150	July 25, 2032	7,566,543
Canada Index Linked Government Bonds	3.000	January 12, 2036	6,997,487
Federal National Mortgage Assn. Single Family Mortgage 30-year	5.000	July 14, 2005	6,900,000
United States Treasury Inflation-Linked Bonds	2.000	January 15, 2014	6,507,416
United States Treasury Notes	3.125	January 31, 2007	6,463,590
France Government OATEI	3.000	July 25, 2012	5,669,627
United States Treasury Inflation-Linked Bonds	0.875	April 15, 2005	5,508,943
Sweden Index Linked Government Bonds	0.000	January 4, 2014	5,367,248
Canada Inflation-Linked Government Bonds	4.250	January 12, 2021	5,287,389

A complete list of the portfolio holdings can be obtained by contacting the Board of Investment Trustees office.

EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF INVESTMENT RESULTS
JUNE 30, 2005

Asset Class Manager	1 Year		3 Year		5 Year	
Domestic Equities						
BGI Russell 3000 Fund*	8.12	%	9.47	%	-	%
RhumbLine Advisors	7.97		9.24		(1.71)	
Systematic Financial Mgt.	15.70		13.33		8.20	
Numeric Investors-Core	11.71		12.39		2.50	
Goldman Sachs*	2.25		-		-	
Numeric Investors-Small Cap	8.90		16.23		0.25	
Wellington*	20.42		-		-	
Combined Domestic Equities	9.80		10.54		1.14	
**Russell 3000	8.06		9.46		(1.35)	
Alternative Investments (a)						
Adams Street*	1.14		-		-	
HarbourVest*	22.60		-		-	
International Equities						
Marathon*	16.70		-		-	
Capital Guardian	14.14		12.44		(0.91)	
Mondrian *	-		-		-	
BGI EAFE Fund*	13.99		12.39		-	
Combined International Equities	16.03		15.17		1.50	
**MSCI All Country World X US	16.95		14.08		0.76	
Real Estate						
Total Real Estate Funds	(20.18)		(11.93)		(6.13)	
Fixed Income						
JP Morgan	7.71		6.62		7.92	
BlackRock	7.21		6.36		7.92	
WR Huff	10.59		15.85		6.56	
BGI US Debt Fund*	6.85		5.80		-	
Combined Fixed Income	8.04		8.49		7.72	
**Policy Benchmark	7.83		7.84		7.63	
Treasury Inflation Protection Securities						
Bridgewater*	12.02		-		-	
**Custom TIPS Benchmark	10.64		9.86		10.25	
Total Fund	10.54		10.95		4.13	
**Policy Benchmark	9.69	%	10.02	%	2.89	%

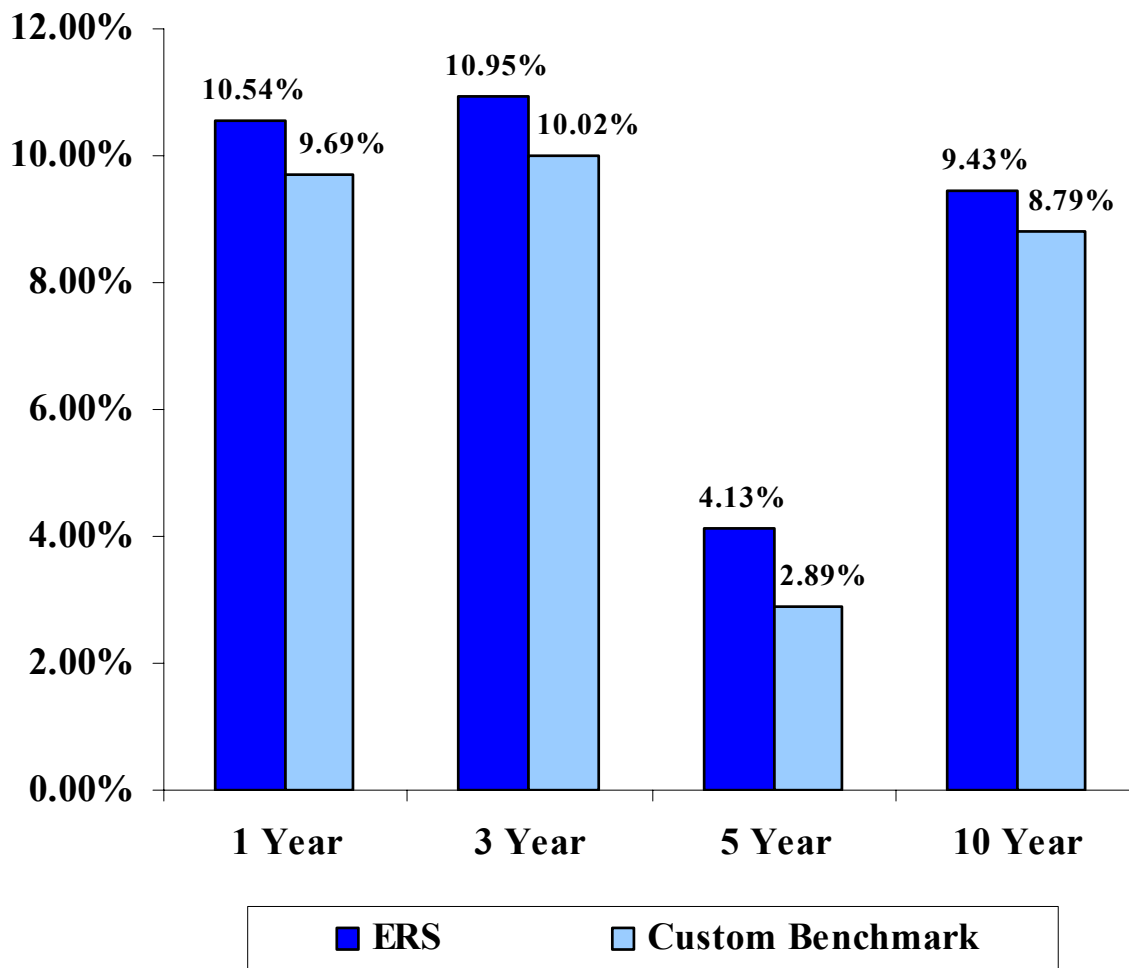
Returns are calculated on a time weighted basis.

*Returns are not available for years indicated.

** Benchmark indexes.

(a) Returns in the early years of private equity are not generally meaningful due to accepted industry valuation standards. Negative performance in the early stages of private equity investing may occur due to the long term nature of the investment.

EMPLOYEES' RETIREMENT SYSTEM
Compound Annual Return
As of June 30, 2005







ACTUARIAL SECTION

Employees' Retirement System

October 26, 2005

Board of Investment Trustees
Montgomery County Government Retirement System
101 Monroe Street
Rockville, MD 20850

Subject:

July 1, 2005 Actuarial Valuation Report

Dear Members of the Board:

Mercer Human Resource Consulting annually performs an actuarial valuation of the Montgomery County Employees' Retirement System for the Montgomery County Government. The most recent actuarial valuation performed was as of July 1, 2005. The purpose of this valuation was to:

- Review experience under the Plan for the year ending June 30, 2005
- Determine the liabilities of the Plan as of June 30, 2005
- Determine the contribution to be paid biweekly during the fiscal year ending June 30, 2007.

The actuarial information in this letter is provided in detail in our valuation report.

Valuation Results

Sections II through IV of the valuation report detail the results of the 2005 valuation, including a breakdown by employee group and plan. This valuation reflects the cost of plan changes as approved by the County resulting from the recent bargaining agreements. The changes improve benefit accruals, change retirement and DROP eligibility, and increase the employee contributions for group G. There were no other changes in plan provisions.

Mercer also conducted an experience study in order to evaluate the appropriateness of the economic assumptions. Only economic assumptions, plus mortality experience, were examined at this time. The 2005 valuation reflects the recommended changes in assumptions. Mercer will evaluate other demographic assumptions and will recommended changes if necessary for the July 1, 2006 actuarial valuation.

Page 2

October 26, 2005

Board of Investment Trustees

Montgomery County Government Retirement System

County Contributions

Contributions are computed using the Projected Unit Credit method of funding. The objective of this method is to fund each participant's benefits under the Plan, as they would accrue, taking into consideration future salary increases. Thus the total pension to which each participant is expected to become entitled is broken down into units; each associated with a year of past or future credited service.

If all actuarial assumptions are met in the future and if there are no plan changes, the plan contribution as a percentage of the payroll covered by this plan is expected to increase. This is because the Optional Plans are closed to new non-public safety members; hence, the average age of active members is expected to increase in the future. Normal cost per active member in the closed groups will increase at roughly the valuation interest rate, which is higher than the assumed salary scale.

The July 1, 2005 actuarial valuation sets the County's contribution rates for the fiscal year ending June 30, 2007. The rates are set separately for public safety and non-public safety employee groups and will be applied to each group's total covered payroll for the fiscal year 2007. Thus, the exact dollar amount of the required contribution will not be known until the end of the fiscal year 2007. The contribution rates for fiscal year 2007 were determined based on the total payroll at July 1, 2005, taking into account the general wage adjustments for FY06 made on July 10, 2005, and January 8, 2006.

Investments

During the 2004-2005 plan year, the rate of return after investment expenses on market value of assets was 10.0%. On a market value basis, the return was \$38.6 million more than the 8% assumed rate of return. This \$38.6 million gain is phased in over a five-year period. Gains and losses from 2004-2005 and prior years produced a net loss on an actuarial value of assets basis. As of July 1, 2005, net investment gains of \$44.2 million had not yet been recognized in the actuarial value of assets.

The 2005 valuation was based on an actuarial value of assets of \$2,100,532,623.

We used the financial information provided by the County without further audit.

Page 3

October 26, 2005

Board of Investment Trustees

Montgomery County Government Retirement System

Aetna Contract

The value of the Aetna non-participating group-annuity contract is excluded from all calculations.

Actuarial Assumptions

In order to quantify plan liabilities, a number of actuarial assumptions need to be set. As mentioned earlier, the 2005 valuation reflects the recommended changes in assumptions arising from the recent experience study. Below is a summary of the changes in actuarial assumptions:

	2004 valuation	2005 valuation
Healthy Mortality	1983 Group Annuity Mortality Table	Mixed collar RP2000 mortality table projected ten years
Disabled Mortality	1983 Group Annuity Mortality Table set forward eight years	Mixed collar RP2000 mortality table set forward five years
Consumer Price Index (CPI)	4.0% per annum	3.5% per annum
Social Security Wage Base (SSWB) Increase	4.5% per annum	4.5% per annum
Investment Return Rate	8.0% per annum, net of investment and administrative expenses	8.0% per annum, net of investment expenses
Expense Loading	None	Anticipated administrative expense equal to average of the prior three years of administrative expenses minus \$300,000. For FY07, this figure is \$1,680,000.
Salary Increase	Age-dependent table that varies from 5.1% to 8.1%.	Age-dependent table that varies from 4.75% to 7.5%.

All other assumptions are the same as in the 2004 valuation. The actuarial assumptions used in the current valuation are described in detail in Section VI of the report.

Page 4

October 26, 2005

Board of Investment Trustees

Montgomery County Government Retirement System

Participant Data

Between June 30, 2004 and June 30, 2005, there was a 0.7% increase in the number of plan members. However, the number of active members decreased by 0.7%, from 5,670 to 5,628. The total payroll increased by 3.9%, from \$341.6 million to \$355.1 million.

Aetna provided the retiree data, including benefits. The County provided data on active and terminated vested members. This information would customarily not be verified by a plan's actuary. We have reviewed the information for internal consistency and we have no reason to doubt its substantial accuracy.

Supplementary Information

The July 1, 2005 actuarial valuation report also provides supplemental information, including the schedule of funding progress. This schedule is presented in the financial section of the County's Comprehensive Annual Financial Report (CAFR). This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and to provide a means for making comparisons with other public employee retirement systems.

The County extracted the information from the July 1, 2005 valuation report for the following schedules in the actuarial section and the statistical section of County's Comprehensive Annual Financial Report.

- Summary of Results
- System Contribution
- Membership
- Actuarial Assumptions and Methods
- Solvency Test

Actuarial Certification

All costs, liabilities, and other factors under the Plan were determined in accordance with generally accepted actuarial principles and procedures. The information provided has been determined in accordance with the provisions of Statement Numbers 25 and 27 of the Governmental Accounting Standards Board. The costs are calculated using an actuarial cost

Page 5

October 26, 2005

Board of Investment Trustees

Montgomery County Government Retirement System

method that we believe is appropriate. The actuarial assumptions are reasonable in our opinion and represent our best estimate of the anticipated experience under the Plan.

The undersigned credentialed actuaries meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this report.

Respectfully submitted,


Aquil Ahmed, ASA, EA

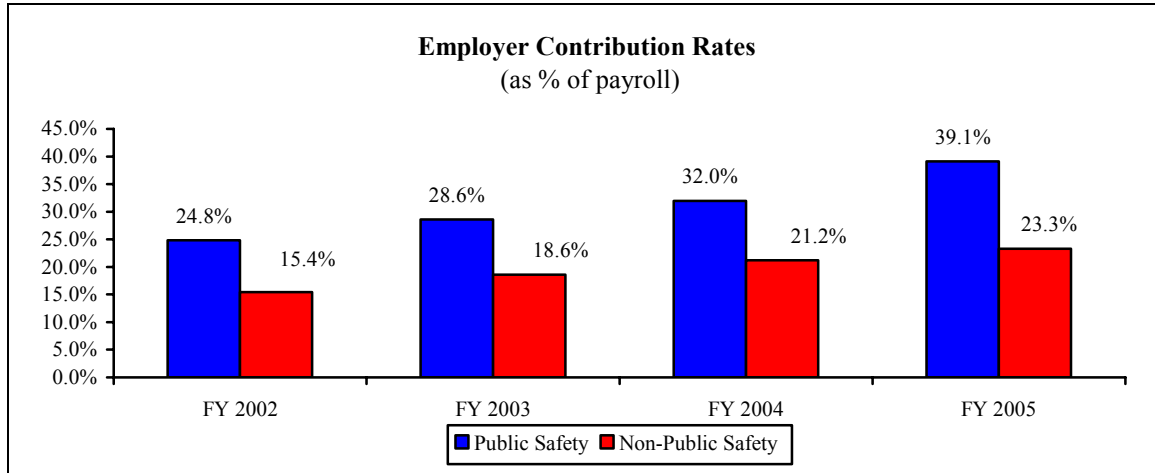

Douglas L. Rowe, FSA, EA

SUMMARY OF VALUATION RESULTS EMPLOYEES' RETIREMENT SYSTEM

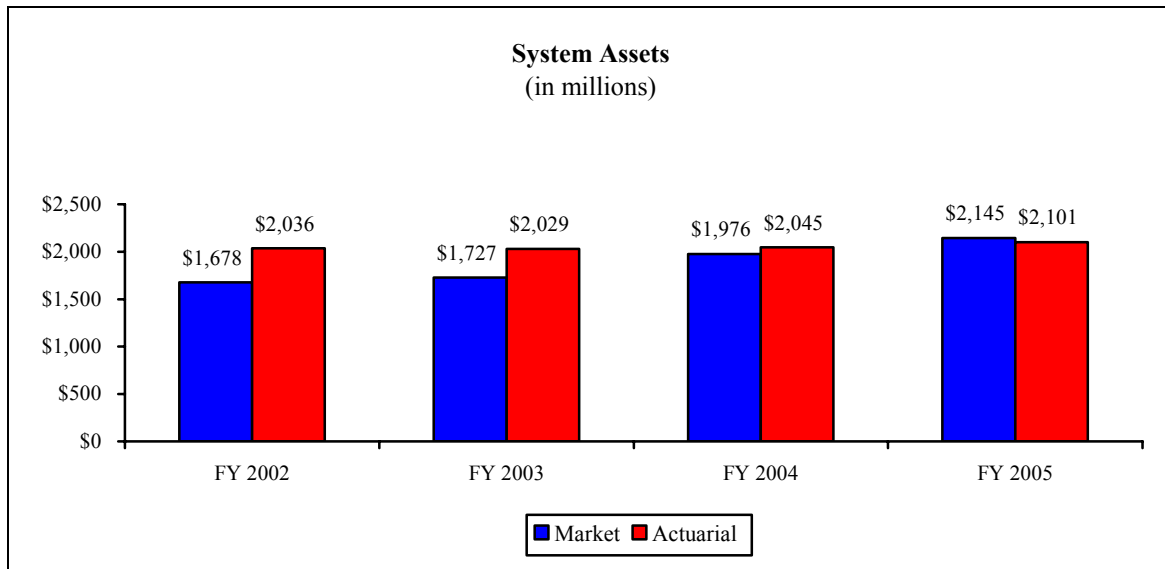
A. Overview

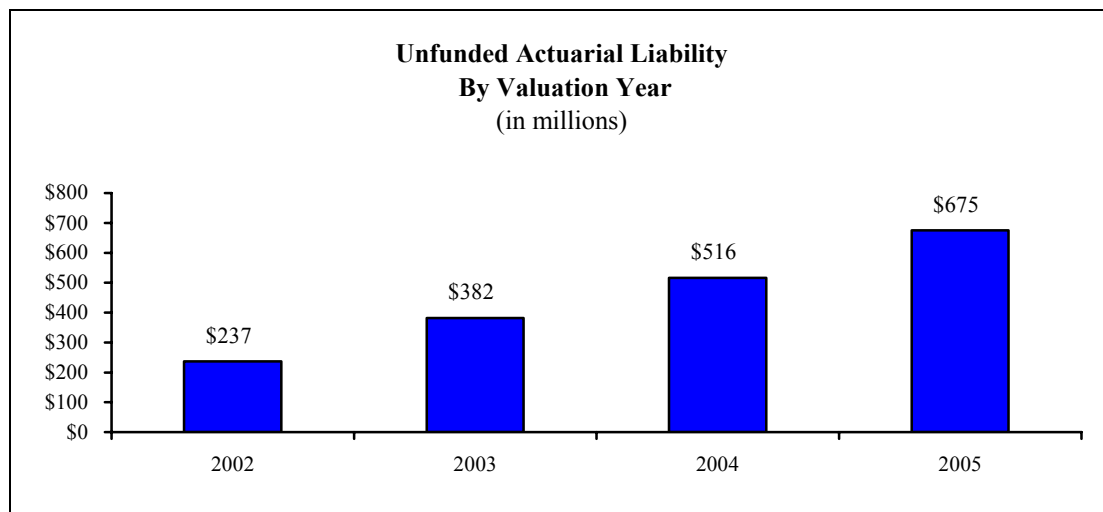
This report presents the results of our June 30, 2005 actuarial valuation of the Montgomery County Employees' Retirement System.

The major findings of the valuation are summarized in the following charts:

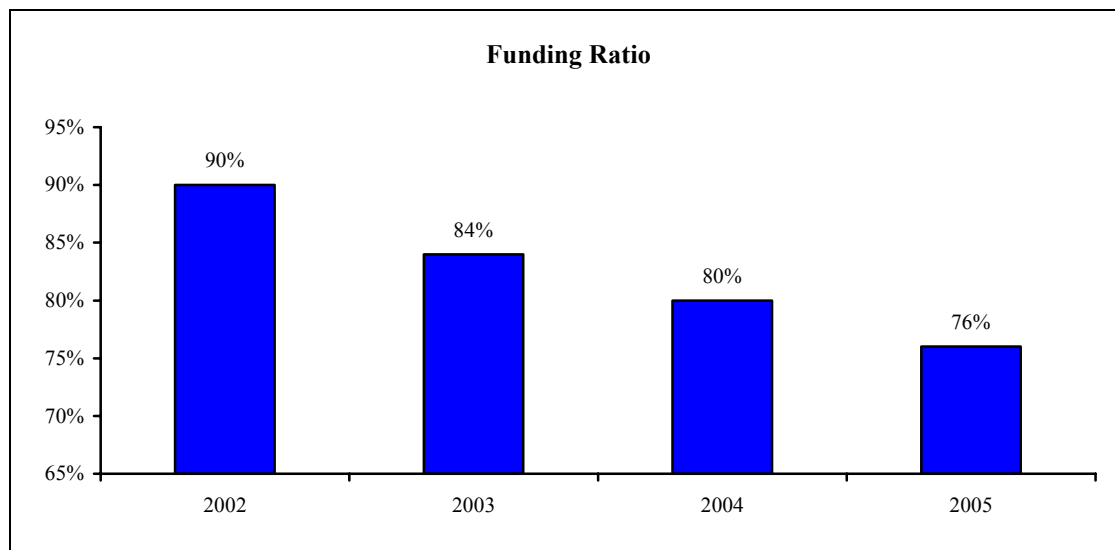


The majority of the increased rate of employer contribution in FY 2005 was due to increased plan benefits.





The unfunded actuarial liability increased in FY 2005 due to the loss on the actuarial value of assets, demographic factors, normal cost, interest, and contributions.



The ratio of actuarial assets to the actuarial accrued liability remained below 100% this year.

B. Summary of Results

	<u>July 1, 2004</u>	<u>July 1, 2005</u>
Actuarial Liability		
a. Active Members	\$ 1,207,055,903	\$ 1,349,017,411
b. Retired Members and Beneficiaries	1,336,081,127	1,404,858,151
c. Vested Former Members	18,191,202	21,171,850
d. Total	<u>\$ 2,561,328,232</u>	<u>\$ 2,775,047,412</u>
Valuation Assets	\$ 2,045,098,796	\$ 2,100,532,623
Unfunded Actuarial Liability	\$ 516,229,436	\$ 674,514,789
Normal Cost		
a. Gross Normal Cost	\$ 59,231,455	\$ 68,807,766
b. Anticipated Employee Contributions	<u>\$ 15,322,174</u>	<u>\$ 15,952,772</u>
c. County Normal Cost (a -b)	\$ 43,909,281	\$ 52,854,994
Amortization Payment	\$ 45,759,329	\$ 57,029,177
County Contribution at date shown	\$ 89,668,610	\$ 109,884,171
County FY 2006/FY 2007 Contribution (as a % of covered payroll)		
Public Safety Employee	31.96%	39.11%
Non-Public Safety Employees	21.22%	23.28%

C. Valuation Highlights

1. System Assets

As of June 30, 2005, the System had assets, valued at market, of \$2.145 billion, as compared to \$1.976 billion at June 30, 2004. The increase of \$169 million was attributable to the following:

- a. An increase of \$90 million from employer and employee contributions;
- b. An increase of \$197 million from investment income; and
- c. A decrease of \$118 million due to the payment of benefits to System participants and administrative expenses.

When measured on an actuarial basis, System assets were \$2.101 billion at June 30, 2005, and \$2.045 billion at June 30, 2004. The asset valuation method smoothes the fluctuations generated by intermittent market gains and losses. This method phases-in investment gains and losses arising during and after the 1994 fiscal year over a five-year period from the date established. Effective July 1, 1997, the calculation of the actuarial value of assets was changed to exclude the present value of estimated accrued contributions.

2. System Liabilities

The Unfunded Actuarial Liability increased \$158.3 million, from \$516.2 million at July 1, 2004, to \$674.5 million at July 1, 2005, as follows:

Actual Unfunded Liability at beginning of year	\$ 516,229,436
Actual Unfunded Liability at end of year	<u>674,514,789</u>
Increase in Actual Unfunded Liability	<u>\$ (158,285,353)</u>

The increase in Actual Unfunded Liability for the year ended June 30, 2005, is comprised of the following:

Increase due to loss on actuarial value of assets	\$ (80,722,008)
Increase due to demographic loss and other factors	(42,163,927)
Increase due to normal cost, interest and contributions	<u>(35,399,418)</u>
Increase in Actual Unfunded Liability	<u>\$ (158,285,353)</u>

3. System Contributions

Contributions to the System include a “normal cost” rate which covers the portion of projected liabilities related to service of members. In addition, an amortization payment is made to fund the unfunded liability related to changes made to benefits in previous years which are being funded over a specific period of time.

The increase in the employer contribution rate is attributable to the following:

	Public Safety		Non- Public Safety	
Employer contribution rate - June 30, 2004	31.96	%	21.22	%
Increase due to loss on actuarial value of assets	1.18		1.68	
Increase due to actuarial gains & losses	0.85		1.16	
Increase due to plan amendment	2.76		-	
Increase (decrease) due to assumption changes	<u>2.36</u>		<u>(0.78)</u>	
Employer contribution rate - June 30, 2005	<u>39.11</u>	%	<u>23.28</u>	%

4. Membership

The active membership of the System decreased from 5,670 at June 30, 2004 to 5,628 at June 30, 2005. The System was closed to all new employees hired after October 1, 1994, except public safety bargaining unit employees. Inactive members, including retirees and beneficiaries, increased from 4,559 at June 30, 2004 to 4,665 at June 30, 2005 and the number of former members with vested rights increased from 367 to 381.

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS EMPLOYEES' RETIREMENT SYSTEM

A. Funding Method

The funding method used for the System's valuation is the "projected unit credit" actuarial cost method. The objective of this method is to allocate the total pension benefit to which each participant is expected to become entitled at retirement to the participant's past and future service. The allocation is accomplished by applying the plan's accrual formula to projected final salary at retirement. An actuarial liability is calculated at the valuation date as the present value of benefits allocated to service prior to that date. The unfunded actuarial liability at the valuation date is the excess of the actuarial liability over the assets of the System.

B. Actuarial Value of Assets

The actuarial value of assets is used for purposes of determining the County's contribution to the System. The asset adjustment method dampens the volatility of asset values that could occur because of short term fluctuations in market conditions. Use of an asset smoothing method is consistent with the long term nature of the actuarial valuation process. Assets are valued at market value but with a phase-in of investment gains and losses arising after July 1, 1994, over a 5-year period. The gains and losses are net of expenses. Effective July 1, 1997, the calculation of the actuarial value of assets does not include the present value of accrued contributions.

**ACTUARIAL ASSUMPTIONS AND METHODS
EMPLOYEES' RETIREMENT SYSTEM**

A. Demographic Assumptions

1. Mortality

**RP2000 projected 10 years, separate tables for males and females
Annual Deaths per 1,000 Members**

Age	Male Deaths	Female Deaths	Age	Male Deaths	Female Deaths
20	0	0	65	11	9
25	0	0	70	19	16
30	0	0	75	33	26
35	1	0	80	58	43
40	1	1	85	103	73
45	1	1	90	176	128
50	2	1	95	262	191
55	3	3	100	341	235
60	6	5	105	398	293

2. Termination of Employment (prior to retirement eligibility)

Annual Terminations per 1,000 Members

Years of Service	Non-Public Safety	Public Safety
0 – 4	75 – 72	80 – 32
5 – 9	70 – 42	29 – 19
10 – 14	35 – 20	15 – 7
15 – 19	18 – 12	6 – 4
20 – 25	11 – 7	3 – 2
26+	6	2

It is assumed that all participants who terminate with five or more years of service elect to receive a refund of their contributions with interest instead of a deferred benefit if they are less than age 41 when they terminate employment.

3. Disability

Age	Annual Disabilities per 1,000 Members			
	Non-Public Safety Employees		Public Safety Employees	
	Male	Female	Male	Female
20	1	1	2	1
25	2	1	4	2
30	3	2	9	6
35	4	3	11	9
40	4	4	14	13
45	5	5	27	25
50	6	5	45	39
55	7	6	55	41
60	12	8	68	42
65	0	0	0	0

4. Deaths

Age	Annual Deaths per 1,000 Disabled Members	
	Male	Female
20	0	0
25	0	0
30	1	0
35	1	1
40	2	1
45	2	2
50	4	3
55	7	5
60	13	10
65	22	17

5. Retirement

Age	Non-Public Safety Employees	Public Safety Employees Other than Group G
41	0%	5%**
42	0%	5%**
43	0%	5%**
44	0%	5%**
45	1%	5%**
46	1%	15%**
47	1%	15%**
48	1%	15%**
49	1%	15%**
50	5%*	15%**
51	5%*	15%**
52	5%*	50%
53	5%*	50%
54	5%*	50%
55	8%*	100%
56	8%*	100%
57	8%*	100%
58	8%*	100%
59	8%*	100%
60	16%	100%
61	16%	100%
62	16%	100%
63	16%	100%
64	16%	100%
65	50%	100%
66	50%	100%
67	75%	100%
68+	100%	100%

* 15% at first eligibility for normal retirement if before age 60, and 20% at first eligibility for normal retirement (between ages 50 and 65) for SLT and Police Telecommunicators.

** For Group G, 30% at first eligibility for normal retirement if before age 52.

Note: Rates apply only when an employee is eligible to retire based on age and service.

6. Sick Leave Credit

Sick leave: Service credit is increased by 2.5% to account for additional credit from unused sick leave. Sick leave is capped at 2 years.

7. Marital assumption

80% of active participants are assumed to be married. Women are assumed to be three years younger than their spouses.

8. Assumption Changes

In October 2005, the System's actuary, Mercer Human Resource Consulting completed an experience study of the actuarial assumptions used for the five-year period ending June 30, 2005. All recommended assumptions were approved by management at that time.

B. Economic Assumptions

- | | |
|---|---|
| 1. Investment Return: | 8.0% compound per annum |
| 2. Cost-of-Living Increases: | 3.5% compound per annum |
| 3. Increase in Social Security Wage Base: | 4.5% compound per annum |
| 4. Expense load: | Anticipated administrative expense equal to the average of the prior three years of administrative expenses adjusted for anticipated changes (which equates to a \$300,000 reduction for FY2007). FY2007, this figure is \$1,680,000. |
| 5. Salary Increase: | Merit and promotional increases assumed to be based on age as shown below: |

Age	Salary Scale
18 – 34	7.50%
35 – 44	6.50%
45 onwards	4.75%

ANALYSIS OF FINANCIAL EXPERIENCE

Gains and Loss in Accrued Liability During Years Ended June 30 Resulting from Differences Between Assumed Experience and Actual Experience

Type of Activity	2002	2003	2004	2005
Investment loss	\$ (76,656,381)	\$ (135,222,000)	\$ (107,257,715)	\$ (80,722,008)
Combined liability experience	<u>(45,546,738)</u>	<u>(16,450,593)</u>	<u>(23,042,239)</u>	<u>(57,173,555)</u>
Loss during year	<u>\$ (122,203,119)</u>	<u>\$ (151,672,593)</u>	<u>\$ (130,299,954)</u>	<u>\$ (137,895,563)</u>

SOLVENCY TEST

Aggregate Accrued Liabilities

Valuation Date	(1) Active Member Contributions	(2) Retirees, Vested Terms, Beneficiaries	(3) Active Members (Employer Financed Portion)	Reported Assets	Portion of Accrued Liabilities Covered by Reported Assets				
					(1)	(2)	(3)		
6/30/1999	\$124,544,357	\$ 943,551,243	\$ 750,895,023	\$ 1,707,450,187	100	%	100	%	85 %
6/30/2000	136,181,427	1,014,314,792	781,418,094	1,911,114,401	100		100		97
6/30/2001	143,356,036	1,029,982,653	938,607,764	1,990,882,017	100		100		87
6/30/2002	146,500,545	1,125,070,362	1,001,608,309	2,036,100,709	100		100		76
6/30/2003	155,686,014	1,247,359,872	1,008,446,838	2,029,314,438	100		100		62
6/30/2004	160,523,789	1,354,272,329	1,046,532,114	2,045,098,796	100		100		51
6/30/2005	166,078,802	1,426,030,001	1,182,938,609	2,100,532,623	100		100		43

SCHEDULE OF RETIREES AND SURVIVORS
During Years Ended June 30

	New Retirees and Disables	Survivors	Total
July 1, 1999	3,457	278	3,735
New retirements and disabilities	226	0	226
Beneficiaries	(34)	34	0
Deaths/benefits ended	(84)	(8)	(92)
July 1, 2000	3,565	304	3,869
New retirements & disabilities	217	0	217
Beneficiaries	(20)	20	0
Deaths/benefits ended	(85)	(12)	(97)
July 1, 2001	3,677	312	3,989
New retirements & disabilities	244	0	244
Beneficiaries	(28)	28	0
Deaths/benefits ended	(108)	(10)	(118)
July 1, 2002	3,785	330	4,115
New retirements & disabilities	340	0	340
Beneficiaries	(22)	22	0
Deaths/benefits ended	(83)	(2)	(85)
July 1, 2003	4,020	350	4,370
New retirements & disabilities	304	0	304
Beneficiaries	(26)	26	0
Deaths/benefits ended	(99)	(16)	(115)
July 1, 2004	4,199	360	4,559
New retirements & disabilities	216	0	216
Beneficiaries	(20)	20	0
Deaths/benefits ended	(99)	(11)	(110)
July 1, 2005	4,296	369	4,665

Schedule of Active Member Valuation Data

<u>Valuation Date</u>	<u>Number</u>	<u>Annual Payroll</u> ^(a)	<u>Annual Average Pay</u>	<u>% Increase in Average Pay</u>
July 1, 1999	6,224	\$300,119,136	\$48,220	4.322%
July 1, 2000	6,093	\$307,367,030	\$50,446	4.617%
July 1, 2001	6,023	\$318,682,907	\$52,911	4.887%
July 1, 2002	5,983	\$333,449,862	\$55,733	5.333%
July 1, 2003	5,876	\$336,019,788	\$57,185	2.606%
July 1, 2004	5,670	\$341,629,327	\$60,252	5.363%
July 1, 2005	5,628	\$355,105,993	\$63,096	4.721%

(a) Total payroll for active participants under retirement age was used for years prior to July 1, 2002.
Beginning July 1, 2002 payroll for all active participants was used.





STATISTICAL SECTION

Employees' Retirement System

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF ADDITIONS BY SOURCE
JUNE 30, 2005

Fiscal Year	Plan Member Contributions	Employer Contributions	Employer Contributions % of Covered Payroll	Net Investment Income	Total Revenues/Losses
2000	\$ 10,924,466	\$ 44,347,078	14.80	\$ 135,337,568	\$ 190,609,112
2001	11,291,541	43,345,296	14.91	(81,374,778)	(26,737,941)
2002	12,943,679	39,168,622	13.12	(124,177,457)	(72,065,156)
2003	14,769,579	55,205,855	17.69	82,174,496	152,149,930
2004	14,761,912	61,927,029	19.42	286,895,100	363,584,041
2005	15,325,785	74,655,371	22.72	197,432,974	287,414,130

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF DEDUCTIONS BY TYPE
JUNE 30, 2005

Fiscal Year	Benefit Payments	Refunds of Contributions	Administrative Expenses	Total Expenses
2000	\$ 76,387,491	\$ 860,699	\$ 1,219,552	\$ 78,467,742
2001	78,434,554	1,066,708	1,688,780	81,190,042
2002	85,322,387	681,375	2,092,364	88,096,126
2003	100,380,392	739,051	2,007,326	103,126,769
2004	111,645,985	796,099	2,066,265	114,508,349
2005	115,634,583	762,338	1,856,977	118,253,898

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF BENEFIT PAYMENTS BY TYPE
JUNE 30, 2005

Fiscal Year	Retiree	Disability	Survivor	Total
2000	\$ 53,463,287	\$ 14,716,815	\$ 3,188,218	\$ 71,368,320
2001	58,415,300	16,234,205	3,785,049	78,434,554
2002	64,030,235	17,250,631	4,041,521	85,322,387
2003	77,008,990	18,559,929	4,811,473	100,380,392
2004	87,122,662	19,491,388	5,031,935	111,645,985
2005*	102,641,063	10,906,765	2,086,755	115,634,583

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF RETIRED MEMBERS BY BENEFIT TYPE
JUNE 30, 2005

Fiscal Year	Retiree	Disability	Survivor	Total
2000	2,831	734	304	3,869
2001	2,918	759	312	3,989
2002	3,002	783	330	4,115
2003	3,203	817	350	4,370
2004	3,348	851	360	4,559
2005*	3,443	853	369	4,665

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF AVERAGE BENEFIT AMOUNTS
JUNE 30, 2005

Fiscal Year	Retiree	Disability	Survivor	Total
2000	\$ 18,885	\$ 20,050	\$ 10,488	\$ 18,446
2001	20,019	21,389	12,132	19,663
2002	21,329	22,031	12,247	20,734
2003	24,043	22,717	13,747	22,970
2004	26,022	22,904	13,978	24,489
2005*	29,812	12,786	5,655	24,788

* Allocation among retirees, disabilities, and survivors are actual amounts. Allocations for FY 2000-2004 were based on estimates.

**SCHEDULE OF PARTICIPATING AGENCIES
AND POLITICAL SUBDIVISIONS**

Montgomery County Revenue Authority
Housing Opportunities Commission of Montgomery County
Town of Chevy Chase
Strathmore Hall Foundation, Inc.
Washington Suburban Transit Commission
Independent Fire/Rescue Corporations

Certain employees of the:
State Department of Assessments and Taxation
District Court of Maryland